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Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

SECURITIES INDUSTRY ASSOCIATION,

Petitioner,

—v.—

ROBERT L. CLARKE, OFFICE OF THE COMPTROLLER OF THE CURRENCY, and SECURITY PACIFIC NATIONAL BANK,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

At issue is an unprecedented judicial interpretation of the Glass-Steagall Act, 12 U.S.C. §§ 24, 378, the primary federal statute governing the structure of the Nation's financial services industry. That Act, this Court repeatedly has held, flatly prohibits banks from "issuing, underwriting, selling or distributing . . . notes, or other securities." The question presented is:

Did the court below err in holding that bank conduct deemed by the Comptroller of the Currency through *ad hoc* regulatory review to be "convenient and useful" to banking can *never* be prohibited by the Glass-Steagall Act, even when the conduct constitutes the issuing, underwriting or distributing of securities within the meaning of the Act's flat prohibitions?

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.*

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* Pursuant to Rule 28.1 of this Court, petitioner Securities Industry Association states that it is a national trade association representing more than 500 securities brokers, dealers and underwriters who are responsible for over 90 percent of the securities brokerage and investment banking business in the United States.

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Petitioner, the Securities Industry Association ("SIA"), respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit, entered in this proceeding on September 8, 1989.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (1a)[1] is reported unofficially at [Current] Fed. Sec. L. Rep. (CCH) ¶ 94,562 (2d Cir. Sept. 8, 1989). The Memorandum and Order of the District Court for the Southern District of New York granting summary judgment in favor of petitioner (43a) is reported at 703 F. Supp. 256. The Final Judgment of the District Court (55a) is unreported. The administrative ruling of

1 References to the Appendix hereto are cited "____a".

Robert L. Clarke, Comptroller of the Currency, (56a) is reported at [1988-89 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,612 (June 16, 1987).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on September 8, 1989. The Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves two sections of the Glass-Steagall Act, designed "to prohibit commercial banks . . . from going into the investment banking business."[2] Section 16 flatly prohibits national banks from underwriting "any issue of securities or stock," with only limited, express exemptions for specified obligations backed by federal and state governments and certain government agencies. 12 U.S.C. § 24 (Seventh). Section 21 of the Act in parallel fashion prohibits all banks from "issuing, underwriting, selling, or distributing" any "stocks, bonds, debentures, notes, or other securities," and also exempts from its prohibition the same government securities exempted from the Section 16 prohibition on underwriting by national banks. 12 U.S.C. § 378(a)(1).

Relevant portions of these provisions are set out in full in the Appendix hereto at 77a-79a.

STATEMENT OF THE CASE

The opinion below concerned a ruling issued in June 1987 by Robert L. Clarke, the Comptroller of the Currency ("Comptroller"). That ruling authorized national banks to underwrite directly to the general public securities backed by conventional mortgage loans, under a rationale that applies equally to other securities as well.

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2 *Investment Co. Institute* v. *Camp*, 401 U.S. 617, 629 (1971).

A. The Administrative Ruling

In January 1987 Security Pacific National Bank (the "Bank") registered a $194 million public offering of securities with the Securities and Exchange Commission ("SEC") and underwrote them directly to the public, without seeking prior approval by any bank regulator. (5a, 45a.) As described in the Bank's Prospectus, the securities were mortgage pass-through certificates. To create these instruments, the Bank first had transferred a pool of mortgage notes from its portfolio to a separate bank, which was to hold them as trustee. The trustee then had transferred the pass-through certificates back to the Bank. Each certificate represented an undivided fractional interest in the trust's pool of mortgage loans, and would pass through to its holder 8.5% annual interest from the payments on the loans received by the trust.[3] The Bank underwrote these certificates to the investing public in denominations of $25,000. (*See* 45a, 58a.)

Neither the certificates nor the underlying mortgage notes were federally guaranteed or insured. To enhance the marketability of the securities, the Bank's corporate parent had arranged other, limited credit support for them, itself guaranteeing against default up to 10% of the principal balance of the loans transferred to the trust. (*See* 7a, 46a, 59a.)

In the Prospectus the Bank identified the certificates as "securities" and acknowledged the Bank's conduct to be "underwriting." (*See* 45a-46a.) The Bank also stated its intent to "buy and sell" (*i.e.*, deal in) the securities from time to time in the secondary market. (*See* 7a, 46a.)

Petitioner, Securities Industry Association ("SIA"), brought the matter to the attention of the Comptroller, who has direct regulatory authority over all nationally chartered banks. Reviewing the Bank's conduct in his June 1987 ruling, the Comptroller concluded it was "authorized under the national banking laws." (57a.) He found the transaction in substance

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3 (45a.) The Bank continued to service the mortgage loans and collect the principal and interest payments under a contract with the trustee. (*Id.*)

"no more than a lawful negotiation or sale of assets." (64a.) The Bank's role in the transaction, as the Comptroller saw it, was "simply an incident of ownership" of the assets and "nothing more than the negotiation of evidences of debt" permitted by 12 U.S.C. § 24 (Seventh), the "incidental powers" provision of the National Bank Act. The Glass-Steagall underwriting prohibition did not apply to an otherwise authorized bank activity because the Act, in the Comptroller's view, cannot restrict "the means" by which a bank conducts its business. (68a-69a n.13.)

Alternatively, the Comptroller found that the Bank "was not involved in a prohibited securities activity within the meaning of the Act." (65a.) Although the certificates were described in the Bank's prospectus as "mortgage related securities," and registered as "securities" with the SEC, the Comptroller concluded the instruments were not "securities" for Glass-Steagall purposes. The Comptroller reasoned that the certificates were "legally transparent," so that certificate holders were, in effect, "owners of the underlying assets," *i.e.*, the mortgage notes. (67a.) The Comptroller did not mention, or try to explain, the contrary and long-standing ruling of his Office under the Glass-Steagall Act that precisely such certificates *are* "securities" that banks "may neither deal in nor underwrite."[4]

The Comptroller further found the Bank was not engaged in "underwriting" or "distributing" the mortgage notes, even though SEC filings again described the Bank as an "underwriter" conducting a "distribution." (69a, n.14.) Those representations, the Comptroller said, had "no bearing on the Glass-Steagall analysis." No "underwriting" occurred in his opinion because the Bank itself had owned the underlying mortgage notes being sold to the public. (69a.)

B. The District Court Decision

The SIA challenged the Comptroller's ruling under the Administrative Procedure Act, 5 U.S.C. §§ 701 *et seq.*, in the United States District Court, and the Bank intervened. Upon

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4 *Investment Securities Regulation*, [1978-79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,082 (Dec. 12, 1977).

cross-motions for summary judgment, the district court held the Comptroller to have impermissibly authorized bank "underwriting" of "securities" in violation of Sections 16 and 21 of the Glass-Steagall Act.[5]

According a plain and ordinary meaning to the terms "securities" and "underwriting," the court held the certificates to be securities and the Bank to be an underwriter of them. The district court concluded that "[i]n this situation, there is no mere sale of assets" and found that the "general statutory banking powers are limited by specific statutory prohibitions" of the Glass-Steagall Act. (50a.) The court also noted that, when Congress has intended to exempt specific securities from the Glass-Steagall Act, it has done so expressly, as it did in 1968 for government guaranteed mortgage-backed certificates,[6] and that Congress in 1984 had rejected an attempt to exempt private mortgage-backed certificates, as here, from the Act's underwriting prohibition.[7]

C. The Court of Appeals Decision

After first rejecting respondents' standing and laches contentions, the court of appeals repeated the Comptroller's rationale at length. Then, deferring to the Comptroller's administrative conclusion that the public sale of mortgage-backed securities is an authorized activity for national banks, the court held that determination "sufficient to resolve the dispute." (29a.)

The court below read this Court's footnote 11 in *SIA* v. *Board of Governors*, 468 U.S. 137, 158 (1984), as providing that any conduct incidental to the business of banking is *per se* beyond the reach of Glass-Steagall. The Second Circuit reasoned:

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5 *See* 55a. The court also denied defendants' motions to dismiss based upon the SIA's alleged lack of standing to maintain this action and supposed laches in commencing it.

6 53a, citing the Housing and Urban Development Act of 1968, Pub. L. No. 90-448 § 804, 82 Stat. 476.

7 53a, citing S. Rep. 293, 98th Cong. 2d Sess. 9, *reprinted in* 1984 U.S. Code Cong. & Admin. News 2809, 2817.

> If the activity constitutes the "business of banking," then the Glass-Steagall Act prohibitions . . . *do not apply*.

(32a; emphasis added.) The court further explained (37a):

> [A]ctivities within the "business of banking" are not intended to be affected by the Glass-Steagall Act's Section 16 prohibition on "underwriting . . . securities."

While no express power in the banking laws authorized the conduct at issue, the court below accepted the Comptroller's rationale that a bank's public sale of mortgage-backed securities is within its "incidental powers," because the activity is "convenient [and] useful" to the exercise of other powers that are expressly granted. (*See* 33a-34a.) Accordingly, the court held, no Glass-Steagall analysis at all was needed to resolve the issue presented:

> Because we uphold the Comptroller's decision based on his determination that [Security Pacific National] Bank's activities were within the "business of banking" *and therefore were not prohibited by the Glass-Steagall Act*, it is unnecessary to consider whether the certificates were "securities" under the Act or whether [Security Pacific National] Bank's activities would constitute "underwriting" under the Act.

(37a; emphasis added.)

Although the Second Circuit found it unnecessary to reach the question, in *dictum* it disagreed with the district court's holding that the particular instruments at issue are "securities" under the Glass-Steagall Act, indicating that the definition of "securities" under federal securities law is not controlling. It also disagreed that hazards and conflicts of interest of concern to Glass-Steagall are inherent in the activity at issue. To the extent such concerns may be present, in the court's view they are adequately accommodated by the disclosure provisions of federal securities law. (*See* 40a-41a.)

At bottom, the court's analysis was limited to reiterating the Comptroller's discussion. Although such matters were fully

briefed, the opinion below did not address the language of the Glass-Steagall Act; the relevant legislative history of the Act; prior contrary administrative rulings—both by the Comptroller and by the Federal Reserve Board—or specific Acts of Congress statutorily recognizing mortgage-backed securities as "securities" within the scope of Glass-Steagall. The court concluded simply that:

> The Comptroller properly determined that [the] Bank's activity was within the "business of banking" under 12 U.S.C. § 24 (Seventh), *and therefore* was not prohibited by the Glass-Steagall Act. (42a; emphasis added.)

REASONS FOR GRANTING THE WRIT

I.

THE DECISION OF THE COURT OF APPEALS RAISES ISSUES OF NATIONAL SIGNIFICANCE CONCERNING THE SCOPE OF PERMISSIBLE CONDUCT BY ALL BANKS

This petition presents issues of crucial significance to the financial services industry throughout the country. As in two previous cases reviewed and reversed by the Court, this petition concerns regulatory authorization for commercial banks, as principals, to underwrite securities directly to the investing public, despite the Glass-Steagall underwriting prohibitions. *See Investment Co. Institute* v. *Camp*, 401 U.S. 617 (1971) ("*ICI*"); *Securities Industry Ass'n* v. *Board of Governors*, 468 U.S. 137 (1984) ("*SIA*"). The issue here is of even greater "importance for the Nation's financial markets." *SIA*, 468 U.S. at 142.

The Glass-Steagall Act has stood, through more than half a century, as the basic statutory underpinning for the structure of the entire financial services industry in this country. The Court repeatedly has confirmed that Congress intended the Act to apply as a series of "flat prohibitions" against bank securities activities, *regardless* of contrary arguments of "competition,

convenience and expertise" which could be made. *ICI*, 401 U.S. at 630; *see also SIA*, 468 U.S. at 147.

The court below held precisely the opposite. Under the Second Circuit's rationale, the single—and determinative—issue in this case is whether proposed securities activities are "convenient and useful" to banking; if so, the activities are to be *per se* permitted, *regardless* of the Glass-Steagall Act. The net effect of the Second Circuit's opinion is to write Glass-Steagall right out of the statute books.

1. The decision below rewrites national banking law. From the time Congress chartered the first Bank of the United States in 1816, national banks always have been institutions of limited, statutorily defined power. They possess no authority beyond that expressly granted by law.[8] If an activity is not properly an incidental power for a national bank, it may not be performed at all. For that reason alone such an activity is a prohibited *ultra vires* act, and the Glass-Steagall Act never comes into play. The court below, however, held the Glass-Steagall prohibitions also "do not apply" (32a) to any bank securities activity properly incidental to banking. Under the Second Circuit rationale, therefore, the Glass-Steagall Act effectively applies to nothing: It "do[es] not apply" to activities that *are* incidental to banking, and it is superfluous with respect to activities that are *not* incidental to banking. The Glass-Steagall Act has become, literally, meaningless.

2. The decision below entirely ignores the legislative history showing beyond doubt that Congress specifically intended the Glass-Steagall Act to eliminate just the sort of "incidental powers" rationale accepted by the Second Circuit.

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8 *E.g., First Nat'l Bank* v. *National Exchange Bank*, 92 U.S. 122, 128 (1875) (dealing in stocks is not expressly prohibited, but such prohibition implied from the failure to grant the power); *California Bank* v. *Kennedy*, 167 U.S. 362, 366 (1897); *Texas & P. Ry.* v. *Pottorff*, 291 U.S. 245, 253 (1934); *Investment Co. Institute* v. *Camp*, 274 F. Supp. 624, 638 (D.D.C. 1967), *rev'd*, 420 F.2d 83 (D.C. Cir. 1969), *rev'd*, 401 U.S. 617 (1971).

Congress first statutorily recognized the authority of national banks to deal in securities in 1927.[9] Before that time banks had begun to engage in the activity without specific authorization or limitation, rationalizing it under the general rubric of an "incidental" banking power—a rationale with which Congress disagreed.[10] Although the McFadden Act of 1927 expressly authorized banks to deal in securities, Congress intended the Act as "primarily regulative" and "restrictive," in that the Act confined the authority solely to dealing in "marketable obligations . . . known as investment securities" and authorized the Comptroller further to restrict that definition.[11]

Subsequently investigating the cause of thousands of bank failures after the stock market crash of 1929, Congress found that, despite the McFadden Act limitation, banks had continued to become involved directly and indirectly in speculative securities and stock. *See ICI*, 401 U.S. at 630. They had become

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9 The McFadden Act amended 12 U.S.C. § 24 (Seventh) to add the following proviso:

> Provided, That the business of buying and selling investment securities shall hereafter be limited to buying and selling without recourse marketable obligations evidencing indebtedness of any person, copartnership, association, or corporation, in the form of bonds, notes and/or debentures, commonly known as "investment securities", under such further definition of the term investment securities as may by regulation be prescribed by the Comptroller of the Currency . . . ."

McFadden Act, c.191, § 2, 44 Stat. 1226 (1927).

10 In hearings on the McFadden Bill, for example, Senator Glass said concerning the earlier bank securities activity, "there is nothing in the national bank act that permits it. We have again the infrequent occurrence of being asked to legalize something that has been done without the authority of law." Hearings before a Subcomm. of the Senate Comm. on Banking and Currency concerning S. 3316, 68th Cong., 2d Sess. 111 (1925). Representative McFadden echoed the same view on the House floor, explaining that his proposed investment securities provision "attempts to legalize that which banks are now doing without the authority of law." 67 Cong. Rec. 3232 (1926).

11 S.Rep. No. 473, 69th Cong. 1st Sess. 7 (1926).

the "dominant force in the investment banking field."[12] As Senator Glass said during investigative hearings in 1931: "We tried to, and thought at the time we had, removed the [federal reserve] system as far as possible from the influences of the stock market"; he wanted "to do something more effective[ ]" in light of developments since 1927.[13]

Congress thus wrote the Glass-Steagall Act as a "prophylactic measure directed against conditions that the experience of the 1920's showed to be great potentials for abuse." *ICI*, 401 U.S. at 639. Congress did not simply delete the McFadden Act provisions concerning bank underwriting of "investment securities" and thereby again leave open the argument that banks' "incidental powers" permitted such activity. Rather, it added "flat prohibitions" to the incidental powers section of the National Bank Act, in order to separate commercial from investment banking "as completely as possible." *SIA*, 468 U.S. at 147.

Section 16 of the Glass-Steagall Act provided that a national bank "*shall not* underwrite *any* issue of securities or stock." 12 U.S.C. § 24 (Seventh) (emphasis added). Section 21 imposed like prohibitions on all depository institutions. 12 U.S.C. § 378. The Glass-Steagall provisions thereby became an affirmative, statutory ban on activities that *might* otherwise again be argued as permitted by banks' "incidental" powers. The contrary holding of the court below simply turns congressional intent upside down.

3. The ruling below recreates dangers to our financial system that Congress intended to eliminate in 1933. A core congressional concern underlying enactment of Glass-Steagall was the potential that banks could set up their loans into pools and then sell interests in them ("securitize" them, in today's

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12 Perkins, *The Divorce of Commercial and Investment Banking: A History*, 88 Banking L.J. 483, 495-96 (1971).

13 Hearings before a Sub-committee of the Senate Committee on Banking and Currency, Hearings Pursuant to S. Res. 71, 71st Cong., 3d Sess. 262 (1931). *See ICI*, 401 U.S. at 629.

jargon) to an unknowing public.[14] As Senator Bulkley said, in often-quoted remarks on the Senate floor:

> If the public is to be protected against the possibility of bad bank loans being set up into bond issues to be sold to savings depositors of the same banks without the exacting scrutiny of an independent underwriter interested primarily in the soundness of the securities he is about to sell we must prohibit the banks from engaging in the security business.

75 Cong. Rec. 9912 (1932). Similarly, Representative Bacon cited as a specific benefit to be gained from the then-proposed Glass Bill:

> The public will be protected against the possibility of being offered bonds which represent bad bank loans or "dirty linen" converted through a security affiliate.

77 Cong. Rec. 3954 (1933).

The activity sanctioned by the decision below encourages just such a "possibility," and any number of other conflicts of interest Congress meant the Act to prohibit. As the Court has admonished, Congress decided that "the role of a bank as a promoter of securities was fundamentally incompatible with its role as a disinterested lender and adviser." *SIA*, 468 U.S. at 154; *see ICI*, 401 U.S. at 629-34 (1971). Concerns about "unsound loans" made to facilitate a securities distribution, loss of depositor confidence from poor investments sold by a bank, and other conflicts of interest were equally addressed by the prohibitions in Glass-Steagall. *ICI*, 401 U.S. at 630-31.

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14 Packaging mortgages and selling interests in them to the public had become a widely utilized technique during the 1920's. *E.g.*, E. Barbeau, *The Mortgage Bond Racket* 19 (1932) ("[c]ompanies were formed to make it possible for the individual of small means to invest in mortgages through the splitting up of mortgages, into many small-sized units"). The practice included the "grouping of mortgages, so as to support monster and, often, monstrous issues of mortgage certificates, a single issue running to tens of millions of dollars," which frequently would be sold to the public through a "Certificate[ ] of Participation." H. Aron, *The Mortgage Problem* 35, 51 (1934).

Each of these concerns is manifest here. Among other things, the activity approved permits bank-affiliated credit enhancement to make the certificates easier to sell; promotes public reliance on the reputation of a bank when purchasing the securities; and creates a bank's "salesman's stake" in selling the securities.

4. As an opinion of the federal appellate court with jurisdiction over the center of the nation's financial markets, the decision below has incalculable economic as well as legal effect. Almost certainly the decision will impel further efforts by banks to dismantle the statutory structure built by Congress to govern the financial markets of this country.

Because the decision encompasses both Sections 16 and 21 of the Glass-Steagall Act, 12 U.S.C. §§ 24 (Seventh), 378, it applies to *all* depository institutions, wherever chartered. The decision effectively removes the Glass-Steagall underwriting prohibition from all 4,300 national banks, 8,600 state-chartered banks and 3,500 savings and loans doing business in this country.

The opinion below also would authorize bank underwriting of virtually all securities. The opinion expressly permits banks to act as underwriter of all mortgage backed securities, a market that alone exceeded $97 billion in new offerings last year.[15] Its rationale equally grants banks the right to "securitize" and "sell" to the public interests in pools of any other loans they originate—from consumer loans to Third World debt. Many large money center banks, for example, doubtless will argue it "convenient and useful" to convert high risk loans made to finance leveraged buy-outs into fractional units (so-called "junk bonds") that can be marketed to individual depositors.[16] Similar arguments could be advanced for countless other securi-

15 *Investment Dealers Digest*, Jan. 9, 1989, at 29.

16 *Cf.* Horowitz, *Bank Partnerships to Buy LBO-Backed Securities*, Am. Bankr., Sept. 22, 1989, at 14, col. 1 ("[b]anks eager to rid their books of leveraged buyout loans continue to find new outlets").

ties.[17] At least one bank already has announced plans to develop a retail market among its individual customers in order to "securitize" and sell securities representing interests in its credit card receivables in $1,000 denominations.[18]

Nor is the rationale of the decision below limited to underwriting bank-originated debt. According to the Second Circuit any activity administratively deemed "convenient and useful" to banking is *per se* outside Glass-Steagall. (34a.) Banks may, and do, own billions of dollars of "investment securities." *See* 12 C.F.R. § 1.3(b) (1989). Under the Second Circuit rationale, therefore, all banks could underwrite to the public any such securities, despite the Glass-Steagall bar, as a "convenient and useful" way of selling them.

5. The ruling below already has created anomalies in the regulation of bank securities activities. Two months before the Comptroller ruled, the Federal Reserve Board (the "Board"), with primary regulatory jurisdiction over all state member banks of the Federal Reserve System, reconfirmed *its* view that mortgage-backed securities are "ineligible" securities under Section 16 of the Glass-Steagall Act. As the Board put it, such securities "may not under that section be underwritten or dealt in by member banks."[19] Congressional concern about the sort of activities at issue in this case, the Board observed, was "one of the principal reasons for the Glass-Steagall Act." (73 Fed. Res. Bull. at 499.)

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17 *See, e.g.*, Forde, *Citibank Reveals Method of Packaging Ex-IM Loans*, Am. Bankr., July 20, 1989, at 15, col. 2 (bank announces sale of securities representing interests in loans guaranteed by the Export-Import Bank); Parker, *Securitization Ideas Unveiled*, Pensions & Investments Age, Sept. 18, 1989, at 43 (discussing new securities offerings including interests in pools of equipment leases backed by bank letter of credit, pools of bank-originated automobile loans and pools of bank-originated recreational vehicle loans).

18 *See* Quinn, *For Small Investor, Plastic Bonds' Higher Yields Aren't Worth Trouble*, Chicago Tribune, Oct. 16, 1989, at C7.

19 *Citicorp*, 73 Fed. Res. Bull. 473, 473 (1987), *aff'd*, *SIA* v. *Board of Governors*, 839 F.2d 47 (2d Cir.), *cert. denied*, 108 S.Ct. 2830 (1988).

The Board refused under the Bank Holding Company Act to permit even bank *affiliates* to underwrite mortgage-backed securities originated and sponsored by their affiliated banks, until after two more years of study, and subsequent to the decision below. Even then, the Board limited the activity to no more than 10% of the affiliate's gross revenues, required that the securities be rated by an independent, nationally recognized rating agency or guaranteed by a government agency, and subjected the activities to a melange of other regulatory "firewalls" the Board has promulgated in an attempt to limit risks and conflicts of interest in the securities activities of bank affiliates.[20]

By affirming the Comptroller's permission for banks themselves to engage in the conduct, the decision below permits risky securities underwriting to be channeled into national banks and away from the regulatory framework promulgated by the Board for bank affiliates. The decision thereby turns inside-out the intent of Glass-Steagall to remove such risks completely from banks, regardless of the level of risk acceptable for non-bank affiliates. *See Board of Governors* v. *ICI*, 450 U.S. 46, 60 (1981).

In sum, the implications of the holding below are far-reaching and fundamental to the methods of finance practiced in this country and to the appropriate interpretation of federal banking laws governing that conduct. For this reason alone, review by the Court is warranted.

II.

THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH CONTROLLING PRECEDENT OF THIS COURT

The Court of Appeals' decision is a radical departure from the Glass-Steagall analysis mandated by this Court. The deci-

20 *Order Approving Modifications to Section 20 Orders*, Fed. Res. Press Release, Sept. 21, 1989; *See also Citicorp*, 73 Fed. Res. Bull. at 502-05.

sion negates both the rationale and the results of this Court's two previous opinions concerning securities activities conducted, as here, directly by a bank. *ICI*, 401 U.S. at 617; *SIA*, 468 U.S. at 137.

ICI arose from the Comptroller's authorization for banks to distribute shares in a mutual investment fund as part of banks' "fiduciary" powers under 12 U.S.C. § 92a. There was no doubt in that case that national banks were permitted under the banking laws to pool trust assets, act as a managing agent and purchase stock for the account of these customers. 401 U.S. at 624-25. Nevertheless, the Court held in no uncertain terms that the shares distributed by the fund were "securities" covered by the Glass-Steagall Act and that banks were therefore prohibited from distributing them to the public.

SIA arose from a Federal Reserve Board ruling that bank distribution of commercial paper was not prohibited by the Glass-Steagall Act. Again, there was no doubt that banks were permitted under banking laws to discount commercial paper and had done so for decades. 468 U.S. at 158. But, again, the Court found commercial paper was a "security" within the express prohibitions of the Glass-Steagall Act and accordingly that banks were prohibited from underwriting it.

The Court therefore twice has made clear that an incidental powers review is just the beginning, *not* the end, of Glass-Steagall analysis; Glass-Steagall is a prohibition against otherwise permitted conduct. In direct contrast, the court below concluded that an incidental powers review is both the beginning *and* the end of Glass-Steagall analysis. In its view, once activities are properly found incidental to banking, they are "*therefore* . . . not prohibited by the Glass-Steagall Act." (37a; emphases added.) Under the Second Circuit's rationale, this Court was just plain wrong in concluding that, because of Glass-Steagall, banks may not underwrite shares in mutual funds or publicly distribute commercial paper.

The court below rested its entire analysis upon a footnote in *SIA*, which it misread as supposedly holding that no activity deemed part of the "business of banking" can be prohibited by

Glass-Steagall. (32a.) But obviously the Court did not intend its footnote to contravene what was said in the text of *SIA*, or in its earlier, detailed analysis in *ICI*. The footnote simply observes that traditional discounting of commercial paper, which clearly is a part of the "business of banking," does not also constitute the prohibited "dealing" in securities. *SIA*, 468 U.S. at 159, n.11.

As appears from the Court's textual holding in *SIA*, when conduct that may constitute discounting of notes also involves public distribution of those notes, that conduct falls within the Glass-Steagall prohibition and is barred to banks. As the Court stated:

> [T]he authority to discount commercial paper is very different from the authority to underwrite it. The former places banks in their traditional role as a prudent lender. The latter places a commercial bank in the role of an investment banker, which is precisely what Congress sought to prohibit in the [Glass-Steagall] Act.

SIA, 468 U.S. at 158.

There is no *per se* exemption from the Glass-Steagall prohibitions for conduct deemed "convenient and useful" to banking. The Court in *ICI*, again contrary to the holding below, had made clear that the Glass-Steagall Congress intended to cover bank securities conduct *despite* its arguable convenience to banking. As the Court put it:

> From the perspective of competition, *convenience*, and expertise, there are arguments to be made in support of allowing commercial banks to enter the investment banking business. But Congress determined that the hazards outlined above made it necessary to prohibit this activity to commercial banks.

ICI, 401 U.S. at 636 (emphasis added).

Under the Second Circuit's rationale it no longer matters whether a bank's securities conduct comprises "issuing, underwriting, selling or distributing" under the Glass-Steagall Act;

whether the instruments involved in such conduct are "notes, or other securities" within that Act; or whether bank securities activities cause just the sort of conflicts of interest and other hazards that Congress enacted the Glass-Steagall Act to foreclose. It *only* matters whether an activity administratively is deemed "convenient and useful" to banking.

If permitted to stand, the decision below at the very minimum will be the source of substantial confusion, and consequent litigation, concerning both the scope and application of the Glass-Steagall prohibitions and the continuing efficacy of this Court's Glass-Steagall analysis. For this reason, too, this case warrants review.

III.

THE DECISION OF THE COURT OF APPEALS RAISES FUNDAMENTAL QUESTIONS CONCERNING THE SEPARATION OF POWERS MANDATED BY THE CONSTITUTION

More than simply a matter of statutory construction, the opinion below raises serious separation of powers issues. Through the Glass-Steagall Act Congress decided, as a matter of national policy, that banks "shall not underwrite any issue of securities or stock." And, Congress decided *not* to delegate any exemptive power from that statutory prohibition to any agency. As a matter of legislative policy, Congress declared that it—and only it—will determine what securities may be underwritten by banks. The decision below contravenes this clear congressional determination and fails to demonstrate "a respect for the coequal Legislative Branch." *Public Citizen* v. *United States Dep't of Justice*, 109 S.Ct. 2558, 2574 (1989) (Kennedy, J., concurring).

1. In debating the Act, Congress deliberated at length over whether to adopt a regulatory approach in the Glass-Steagall Act or whether to enact flat statutory prohibitions. It chose the latter. As the Court has confirmed:

> Congress rejected the view of those who preferred legislation that simply would regulate the underwriting activities of commercial banks. Congress chose instead a broad structural approach that would . . . [operate] [t]hrough flat prohibitions.

SIA, 468 U.S. at 147. Most significantly, the Glass-Steagall Act rescinded the Comptroller's regulatory authority, extended by the McFadden Act in 1927, to exclude "by regulation" any "undesirable or unsafe" instruments from the authority of banks to underwrite securities.[21] Instead, after Glass-Steagall, the Comptroller was left only with the authority to define which securities banks could purchase (not underwrite) for their own accounts.[22] Congress retained for itself the authority to determine what, if any, securities were to be eligible for bank underwriting.

2. Congress repeatedly has affirmed its decision to retain this exemptive prerogative. In 1935 Congress refused to amend the Glass-Steagall Act to permit "national banks under regulations by the Comptroller of the Currency . . . to underwrite and sell bonds, debentures and notes."[23] Again, as recently as 1980, Congress gave the Comptroller rule-making authority necessary "to carry out the responsibilities of the office," but still continued to withhold *any* such regulatory authority with respect to "securities activities of National Banks under the Act commonly known as the 'Glass-Steagall Act.' "[24]

3. Congress has carefully exercised its retained authority throughout the intervening decades. Congress has passed at

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21 S. Rep. No. 473, 69th Cong., 1st Sess. 7 (1926).

22 As a result of Glass-Steagall, the proviso in 12 U.S.C. § 24 (Seventh) states "*provided*, that [a bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe." *Compare*, language in the McFadden Act, *supra*, n.9.

23 *See SIA*, 468 U.S. at 153, *quoting* H.R. Conf. Rep. No. 1822, 74th Cong., 1st Sess. 53 (1935).

24 *See SIA*, 468 U.S. at 153-54, *quoting* Depository Institutions Deregulation and Monetary Control Act of 1980, 708, 94 Stat. 188, 12 U.S.C. § 93a.

least 17 statutes since 1933 expressly exempting various securities from the Glass-Steagall underwriting ban.[25] In each instance the instruments exempted were limited to governmentally issued or guaranteed securities.

Congress also has specifically addressed through legislation bank underwriting of mortgage pass-through certificates. It has statutorily allowed banks to issue and sell such instruments, but only when they are backed by a federal guarantee, and not otherwise.

In 1968 Congress added subsection Ninth to the "powers" provision of national banking laws, 12 U.S.C. § 24, granting express, new authority for national banks to "issue and sell" mortgage-backed certificates if they are guaranteed by the Government National Mortgage Association, and simultaneously exempted the same securities from the prohibition of Section 21 of the Glass-Steagall Act.[26] Obviously Congress understood that, absent these amendments, banks are prohibited from marketing such certificates; otherwise, the amendments would have been superfluous.[27] *A fortiori*, Congress recognized that banks have no such power for certificates that, as here, are neither federally guaranteed nor backed by federally guaranteed mortgages.

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25 The numerous congressional amendments to 12 U.S.C. § 24 (Seventh) are reflected in the legislative history recited in 12 U.S.C.A. § 24 (West 1989) at 37-43.

26 Housing and Urban Development Act of 1968, Pub. L. No. 90-448, § 804, 82 Stat. 476. Specifically, the new subparagraph Ninth of 12 U.S.C. § 24 permitted banks to "issue and sell securities which are guaranteed pursuant to section 1721(g) of this title." The "securities" guaranteed under the latter section, in turn, include "trust certificates or other securities" as are "issued" by an approved bank and backed "by a trust or pool composed of mortgages" insured pursuant to specific federal statutes. 12 U.S.C. § 1721(g).

27 The Conference Report left no doubt in that respect, expressly delineating the new provisions as "*making it possible* for savings and loan associations and banks to issue and sell GNMA guaranteed securities." Cong. Rep. No. 1785, 90th Cong., 2d Sess., *reprinted in* 1968 U.S. Code Cong. & Admin. News. 3053, 3063 (emphasis added).

Subsequent congressional action underscored this understanding. In 1984 Congress amended Section 16 of the Glass-Steagall Act to exempt private mortgage-backed securities from the limitation on bank *purchases* of securities for their own accounts,[28] again confirming that such certificates are Glass-Steagall "securities." Congress did not exempt such private securities—the same type of security sold by the Bank here—from the Glass-Steagall prohibition against underwriting and actually *deleted* a proposal for such an exemption from legislation considered by the Senate.[29]

The court below failed to say one word about these congressional actions, even though they bear directly upon the specific conduct and instruments at issue—making clear that banks may not engage in the public sale of private mortgage-backed certificates—and even though both statutes had been cited by the district court and argued at length to the court of appeals. Under the Second Circuit's analysis, the only relevant issue was whether a securities offering is "convenient and useful" (and therefore "incidental") to banking, an issue left to *ad hoc* regulatory determination by the Comptroller.

The opinion thus creates just the sort of regulatory approach that "Congress rejected . . . when it drafted the [Glass-Steagall Act], and it has adhered to . . . ever since." *SIA*, 468 U.S. at 153. It permitted the Comptroller to accomplish by administrative fiat precisely what Congress has chosen to prohibit.

4. This Court has stressed that judicial deference to an administrative ruling must rest upon the ruling's "power to per-

28 Secondary Mortgage Market Enhancement Act of 1984, Pub. L. No. 98-440, § 105(c), 98 Stat. 1689.

29 S. 2851, 98th Cong., 2d Sess. (1984). The Senate Banking Committee explained that the provision "empowering depository institutions to also underwrite and deal in mortgage-backed securities was removed . . . in deference to both the Administration, and the SEC." S. Rep. No. 293, 98th Cong., 2d Sess. 9, *reprinted in* 1984 U.S. Code Cong. & Admin. News 2809, 2817.

suade."[30] Yet, in this case the Comptroller did not even attempt to reconcile his ruling with the earlier contrary determination of his own office that the kind of certificates here involved do constitute "securities" under the Glass-Steagall Act which a bank "may purchase and sell for its own account . . . *but may neither deal in nor underwrite*."[31] Nor did the Comptroller mention that, two months before his ruling, the Federal Reserve Board had reaffirmed the Board's own long-standing interpretation that such mortgage-backed securities are "securities" that may not "be underwritten or dealt in by member banks" under the Glass-Steagall Act.[32] Nor did the Comptroller relate his ruling to the recent congressional action through which Congress statutorily exempted such mortgage-backed securities solely from the Glass-Steagall purchasing limitations and rejected legislation that would also have removed those instruments from the Act's underwriting prohibitions.[33]

The court below granted uncritical deference to the Comptroller's regulatory about-face, without one word about these obviously significant shortcomings.[34] Although it was obliged to scrutinize the agency determination,[35] and to reject it if inconsistent with clear statutory language,[36] legislative history[37]

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30 *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944); *see NLRB* v. *United Food & Commercial Workers Union*, 484 U.S. 112, 124 n.20 (1987).

31 *Investment Securities Regulation*, [1978-79 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,082 (Dec. 12, 1977) (emphasis added).

32 *Citicorp*, 73 Fed. Res. Bull. at 473.

33 Secondary Mortgage Market Enhancement Act of 1984, Pub. L. No. 98-440, § 105(c), 98 Stat. 1689. *See* p. 20, *supra*.

34 *See Immigration & Naturalization Serv.* v. *Cardoza-Fonseca*, 480 U.S. 421, 446 n.30 (1987) ("considerably less deference" to reversal of agency position); *Watt* v. *Alaska*, 451 U.S. 259, 273 (1981) (same).

35 *See, e.g.*, *Southeastern Community College* v. *Davis*, 442 U.S. 397 (1979).

36 *See, e.g.*, *SEC* v. *Sloan*, 436 U.S. 103, 117-18 (1978).

37 *See, e.g.*, *Federal Maritime Comm'n* v. *Seatrain Lines, Inc.*, 411 U.S. 726, 736-44 (1973).

or statutory purposes,[38] the Second Circuit failed to undertake this task. Instead, merely reciting the Comptroller's ruling at length and rubber-stamping it as "reasonable," the court permitted " 'unauthorized assumption by an agency of major policy decisions properly made by Congress.' "[39] Again, review is warranted.

CONCLUSION

For the foregoing reasons, the requested Writ of Certiorari should issue.

Dated: November 9, 1989

Respectfully submitted,

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38 *See, e.g., Morton* v. *Ruiz*, 415 U.S. 199, 237 (1974).

39 *Bureau of Alcohol, Tobacco & Firearms* v. *Federal Labor Relations Auth.*, 464 U.S. 89, 97 (1983) (quoting *American Ship Bldg. Co.* v. *NLRB*, 380 U.S. 300, 318 (1965)).

APPENDIX

TABLE OF APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1124, 1125—August Term, 1988

(Argued May 23, 1989 Decided September 8, 1989)

Docket Nos. 89-6027, 89-6029

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff-Appellee,

—v.—

ROBERT L. CLARKE and OFFICE OF THE COMPTROLLER OF THE CURRENCY,

Defendants-Appellants,

—v.—

SECURITY PACIFIC NATIONAL BANK,

Intervenor-Defendant-Appellant.

Before:

VAN GRAAFEILAND, MESKILL and WINTER, *Circuit Judges.*

Appeal from a judgment of the United States District Court for the Southern District of New York, Duffy, *J.*

Plaintiff-appellee Securities Industry Association brought this action challenging a decision of defendant-appellant Robert L. Clarke, the Comptroller of the Currency, that the sale of mortgage pass-through certificates by intervenor-defendant-appellant Security Pacific National Bank did not violate federal banking laws. The district court granted the summary judgment motion of Securities Industry Association, thereby invalidating the Comptroller's decision. Clarke, the Office of the Comptroller of the Currency and Security Pacific National Bank appeal from the judgment of the district court.

We vacate the judgment of the district court and remand with instructions to dismiss the complaint.

HELEN M. TOOR, Assistant United States Attorney, Southern District of New York, New York City (Benito Romano, United States Attorney for the Southern District of New York, Steven E. Obus, Assistant United States Attorney, Southern District of New York, New York City, L. Robert Griffin, Rosa M. Koppel, Office of the Comptroller of the Currency, Washington, D.C., of counsel), *for Appellants Robert L. Clarke and Office of the Comptroller of the Currency.*

KENNETH L. BACHMAN, JR., Washington, D.C. (Matthew D. Slater, Cleary, Gottlieb, Steen & Hamilton, Washington, D.C., Robert L. Tortoriello, Richard F. Ziegler, Cleary, Gottlieb, Steen & Hamil-

ton, New York City, Russell A. Freeman, Maurice K. DeWolff, Dan C. Aardal, Security Pacific National Bank, Los Angeles, CA, of counsel), *for Intervenor-Appellant Security Pacific National Bank.*

JAMES B. WEIDNER, New York City (David A. Schulz, Mark Holland, R. Scott Henderson, Rogers & Wells, New York City, William J. Fitzpatrick, Securities Industry Association, New York City, Donald J. Crawford, Securities Industry Association, Washington, D.C., of counsel), *for Appellee Securities Industry Association.*

Lewis B. Kaden, Edward J. Kelly, III, Jeffrey D. Berman, Davis Polk & Wardwell, New York City, *for Amicus Curiae New York Clearing House Association.*

John J. Gill, General Counsel, Michael F. Crotty, Associate General Counsel, American Bankers Association, Washington, D.C., *for Amicus Curiae American Bankers Association.*

Michael S. Helfer, Christopher R. Lipsett, Wilmer, Cutler & Pickering, Washington, D.C., *for Amicus Curiae Bank Capital Markets Association.*

MESKILL, *Circuit Judge*:

Plaintiff-appellee Securities Industry Association (SIA) brought the instant action in the United States District Court for the Southern District of New York, Duffy, *J.* SIA's suit challenged a decision of Robert L. Clarke, the Comptroller of the Currency (the Comptroller). The Comptroller determined that the sale of mortgage pass-through certificates by intervenor-defendant-appellant Security Pacific National Bank (SPN Bank) was not in violation of those sections of the Banking Act of 1933, ch. 89, Pub. L. No. 73-66, 48 Stat. 162 (1933) (codified as amended in scattered sections of 12 U.S.C.), commonly referred to as the Glass-Steagall Act. *See Securities Indus. Ass'n* v. *Board of Governors*, 839 F.2d 47, 54-56 (2d Cir.), *cert. denied*, 108 S.Ct. 2830 (1988) (*Citicorp*). The district court granted SIA's Fed. R. Civ. P. 56 motion for summary judgment, rejecting the statutory analysis of the Comptroller's decision. *Securities Indus. Ass'n* v. *Clarke*, 703 F.Supp. 256 (S.D.N.Y. 1988).

We vacate the judgment of the district court and remand with instructions to dismiss the complaint.

BACKGROUND

A. *Mortgage Pass-Through Certificates*

Mortgage pass-through certificates are used by banks as a mechanism for selling mortgage loans. A number of mortgage loans previously originated by a bank are placed in a pool. The bank then transfers the pool to a trust. In exchange for the pool, the trustee transfers to the bank pass-through certificates. These certificates represent frac-

tional undivided interests in the pool of mortgage loans. The certificates may then be sold publicly or privately.

After sale of the certificates, the mortgage loans are often serviced by the originator-bank. In such a case, the bank collects the loan payments and "passes through" the principal and interest on a pro rata basis to the certificate holders. In doing so, the bank may deduct service or other fees.

Use of this mechanism has important benefits for banks, benefits that have resulted in its increasing popularity and use. Because residential mortgage loans typically are of long duration, banks traditionally have bought and sold the loans to facilitate management of their assets and liabilities. Use of the pass-through certificate mechanism makes the sale of these loans easier. Individual loans do not have to be sold separately, and buyers may find it more efficient and less risky to purchase interests in a pool of mortgages instead of single mortgages.

B. *The January 23, 1987 Offering of SPN Bank*

A Prospectus and Prospectus Supplement dated January 23, 1987 described the offering of approximately $194 million of Security Pacific Mortgage Pass-Through Certificates, Series 1987-B.

The Prospectus provided for the creation of a pool consisting of conventional, fixed-rate residential mortgage loans. "Each Mortgage Loan [would] be selected by [SPN Bank] for inclusion in the Mortgage Pool from among those originated by [SPN Bank] in the ordinary course of [SPN Bank's] lending activities as carried on in its offices in California." Certain characteristics of the mortgages to be selected were specified.

The Prospectus provided that, at the time of issuance of the series, "[SPN Bank] will assign the Mortgage Loans in the Mortgage Pool evidenced by that series to the Trustee. . . . The Trustee will, concurrently with such assignment, authenticate and deliver Certificates evidencing such series to [SPN Bank] in exchange for the Mortgage Loans." The freely transferable certificates would represent fractional undivided interests in the Trust Fund.

Limited credit support for the issue was to be provided either by (1) an irrevocable letter of credit issued by SPN Bank, (2) a limited guaranty issued by an entity other than SPN Bank, or (3) third-party mortgage insurance purchased by SPN Bank in its role as servicer of the mortgage loans. If SPN Bank provided its own letter of credit, the coverage was to be no more than ten percent of the initial aggregate principal balance of the mortgage pool. Any risk of delinquency or default not covered by these mechanisms of credit support would be borne by the certificate holders.

The Prospectus provided for distribution of the certificates by any of three methods: "1. By negotiated firm commitment underwriting and public reoffering by underwriters; 2. By placements by [SPN Bank] with institutional investors through agents; and 3. By direct placements by [SPN Bank] with institutional investors."

After the sale of the certificates, SPN Bank was to continue to service the mortgage loans on behalf of the certificate holders for a contractually specified fee. As part of its ongoing responsibilities, SPN Bank would "monthly distribute[ ] to certificate holders the payments received from the mortgagors (net of its servicing fee) based on their pro rata interest in the mortgage loans."

The Prospectus Supplement for Series 1987-B described various characteristics of the mortgages selected for inclusion in the pool for that particular issue. The Supplement also specified that the trustee was to be Union Bank, a California bank. Credit support was to be provided by SPN Bank's parent, Security Pacific Corporation, in the form of a limited guaranty of no more than ten percent of the aggregate principal balance of the mortgage loans. With respect to distribution of this issue, the Supplement provided, in pertinent part:

> Subject to the terms and conditions of [an] Underwriting Agreement . . . among [SPN Bank, its parent Security Pacific Corporation and Kidder, Peabody & Co., Inc.], under which [SPN Bank] and Kidder Peabody . . . will act as [the U]nderwriters . . . , the Certificates are being purchased from [SPN Bank] by the Underwriters upon issuance. Distribution of the Certificates is being made by the Underwriters from time to time in negotiated transactions or otherwise at varying prices to be determined at the time of sale.

On February 23, 1987, the sale of certificates for Series 1987-B closed and the certificates were delivered to their purchasers.

C. *SIA's Challenge to SPN Bank's Offering*

SIA is a national trade association. According to its complaint, its members include "over 500 organizations responsible for more than 90 percent of the securities brokerage and investment banking business of the nation." Its members are in the businesses of "retail and institutional securities brokerage, investment advisory services, securities trading and market making, underwriting and other investment banking functions and related activi-

ties." In an April 2, 1987 letter, SIA wrote to the Comptroller, expressing its "concern" about SPN Bank's Prospectus and Prospectus Supplement for the Series 1987-B issue of mortgage pass-through certificates.[1] SIA stated its belief that SPN Bank's participation in the transaction constituted a violation of the Glass-Steagall Act. The letter asked the Comptroller to review the transaction and "declare the bank's involvement in it to be contrary to the Glass-Steagall Act."

The Comptroller responded to SIA's request by issuing a twenty page letter dated June 16, 1987. Letter from Robert L. Clarke to Russell A. Freeman, O.C.C. Interpretive Letter No. 388, Fed. Banking L. Rep. (CCH) ¶ 85,612, 6 O.C.C. Qtrly. J. No. 4, at 41. The letter was addressed directly to SPN Bank because, as the Comptroller explained, the Office of the Comptroller of the Currency (OCC) "is the primary regulator of [SPN] Bank's activities." A copy of the letter was sent to SIA. The Comptroller found that SPN Bank's offering did not violate the Glass-Steagall Act. The Comptroller concluded that

> the Bank's program, as described in the Prospectus and Prospectus Supplement dated January 23, 1987, is squarely based on long-standing precedent that is fully supported by applicable law and subsequent court decisions interpreting these laws. In pooling its mortgage loans and selling interests therein, the Bank

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1 It was the Prospectus and Prospectus Supplement for Series 1987-B which accompanied SIA's letter to the Comptroller. The record also includes Prospectuses and Prospectus Supplements for three other issues by SPN Bank, Series 1987-A, dated January 23, 1987 and valued at $116 million, Series 1987-C, dated March 20, 1987 and valued at $35 million, and Series 1987-D, dated March 20, 1987 and valued at $270 million.

> is merely engaging in a permitted sale of its mortgage assets. We cannot conclude that the Glass-Steagall Act is intended to preclude banks from conducting this activity.

Unsatisfied with this result, SIA filed a complaint against the Comptroller and the OCC in the United States District Court for the Southern District of New York. SIA sought declaratory and injunctive relief. The complaint claimed that the Comptroller's ruling was "arbitrary, capricious, an abuse of discretion, in excess of his statutory authority and otherwise not in accordance with the law, and that it is, therefore, null and void." SIA asked that the Comptroller be ordered to withdraw his ruling and refrain from approving the requests of banks to engage in similar activity. SIA also asked the court to enjoin the Comptroller "from continuing in effect any other such approvals that may have been granted by the Comptroller."

Pursuant to a stipulation between the parties, the district court ordered the intervention of SPN Bank under Fed. R. Civ. P. 24. The Comptroller and the OCC moved for dismissal of the complaint under Fed. R. Civ. P. 8(c) and 12(b)(1), or, in the alternative, for summary judgment under Fed. R. Civ. P. 56. SPN Bank moved for dismissal under Fed. R. Civ. P. 12(b)(1) or, in the alternative, for summary judgment. SIA cross-moved for summary judgment.

The district court, in a December 19, 1988 Memorandum and Order, granted the summary judgment motion of SIA, rejecting the statutory analysis of the Comptroller's decision. *Securities Indus. Ass'n* v. *Clarke*, 703 F.Supp. 256 (S.D.N.Y. 1988). In a final judgment filed January 4,

1989, the court "ORDERED, ADJUDGED AND DECREED that the bank activities described in the Court's December 19, 1988 Memorandum and Order violate[d] federal law, and the June 16, 1987 ruling of the Comptroller of the Currency approving of such activities is contrary to law, null, void and of no legal force or effect."

The Comptroller, the OCC and SPN Bank appeal from the final judgment of the district court. We vacate the judgment of the district court and remand with instructions to dismiss the complaint.

DISCUSSION

A. *Preliminary Matters*

The Comptroller and SPN Bank both argue that SIA lacks standing to bring this action. The Comptroller also argues that SIA's action should be barred by the equitable doctrine of laches. These arguments were raised below, but the district court did not address them. We reject both arguments and hold that SIA has standing and that the action was timely brought.

1. *Standing*

SIA asserts that both it "and its members are directly interested and aggrieved parties entitled to review and challenge this action of the Comptroller." In *Clarke* v. *Securities Indus. Ass'n*, 479 U.S. 388 (1987) (*Clarke*), the Supreme Court upheld SIA's standing to challenge decisions of the Comptroller to approve "the applications of two national banks for the establishment or purchase of discount brokerage subsidiaries." *Id.* at 390.[2] After an

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2 There was no discussion in *Clarke* specifically addressing whether SIA's standing was based on individual standing or associational

analysis of standing requirements and the governing banking laws, the Court concluded that

> competitors who allege an injury that implicates the policies of the National Bank Act are very reasonable candidates to seek review of the Comptroller's rulings. There is sound reason to infer that Congress "intended [SIA's] class [of plaintiffs] to be relied upon to challenge agency disregard of the law." [*Block* v.] *Community Nutrition Institute*, 467 U.S. [340, 347 (1984)]. And we see no indications of the kind presented in *Community Nutrition Institute* that make "fairly discernible" a congressional intent to preclude review at [SIA's] behest. We conclude, therefore, that [SIA] was a proper party to bring this lawsuit.

Id. at 403. We find the same to be the case here.

The statutory basis for SIA's standing is section 10 of the Administrative Procedure Act, 5 U.S.C. § 702 (1982). That section "grants standing to a person 'aggrieved by agency action within the meaning of a relevant statute.' " *Association of Data Processing Serv. Orgs., Inc.* v. *Camp*, 397 U.S. 150, 153 (1970) (*Data Processing*) (quoting 5 U.S.C. § 702); *see also Clarke*, 479 U.S. at 394. The Supreme Court has indicated that section 702 requires not only "that the complainant be 'adversely affected or aggrieved,' *i.e.*, injured in fact," *Clarke*, 479 U.S. at 395

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standing. *Cf. Pennell* v. *Tri-County Apartment House Owners Ass'n*, 56 U.S.L.W. 4168, 4169 (U.S. Feb. 24, 1988); *Warth* v. *Seldin*, 422 U.S. 490, 511 (1975). Here, SIA asserts injury both to itself and to its members. Appellants make no arguments with respect to the distinct requirements for associational standing, *see Pennell*, 56 U.S.L.W. at 4169 & n.3. We see no reason for distinguishing *Clarke* on such a basis.

(quoting 5 U.S.C. § 702), but also that " 'the interest sought to be protected by the complainant [be] arguably within the zone of interests to be protected or regulated by the statute or constitutional guarantee in question.' " *Id.* at 396 (quoting *Data Processing*, 397 U.S. at 153). The "zone of interests" test "is most usefully understood as a gloss on the meaning of § 702." *Id.* at 400 n.16. The crux of SIA's complaint in this case is that the Comptroller's ruling permits national banks such as SPN Bank to sell mortgage pass-through certificates, an activity SIA alleges is illegal under the Glass-Steagall Act. SIA claims that the Comptroller's ruling will "subject SIA's members to unlawful competition, will deprive them of legitimate business, and will dilute, divert and withdraw a portion of the market pertaining to the underwriting of various securities."

As discussed *infra*, a major purpose of the Glass-Steagall Act was to draw a line between commercial and investment banking, with national banks prohibited from participating in investment banking. *See Securities Indus. Ass'n* v. *Board of Governors*, 468 U.S. 137, 144-48 (1984) (*Bankers Trust I*); *Investment Co. Inst.* v. *Camp*, 401 U.S. 617, 629 (1971) (*Camp*); *Citicorp*, 839 F.2d at 54-56. The Comptroller's decision has the effects of permitting and encouraging national banks to issue mortgage pass-through certificates. *See infra*. SIA's complaint is that such activity constitutes investment banking. SIA, representing participants in the field of investment banking, seeks by this action to prevent competition with its members in that field. *Cf. Investment Co. Inst.* v. *Conover*, 790 F.2d 925, 926 (D.C. Cir.), *cert. denied*, 479 U.S. 939 (1986) (*Conover*). We find it at least "arguable" that the competition SIA seeks to prevent by this action is that legislated against by Congress, and we therefore conclude

that SIA's interests are within the zone of interests protected by the Glass-Steagall Act. *See Clarke*, 479 U.S. at 394-403; *Camp*, 401 U.S. at 620-21; *Arnold Tours, Inc.* v. *Camp*, 400 U.S. 45, 46 (1970) (per curiam); *Data Processing*, 397 U.S. at 156.[3] We thus hold that the zone of interests standing requirement is satisfied here.

Appellants raise lack of standing as a constitutional objection to SIA's right to bring this action.

> Although standing in its outer dimensions is a prudential concept to be shaped by the decisions of the courts as a matter of sound judicial policy and subject to the control of Congress, at its core it becomes a constitutional question; for standing in its most basic aspect can be one of the controlling elements in the definition of a case or controversy under Article III.

ASARCO Inc. v. *Kadish*, 57 U.S.L.W. 4574, 4576 (U.S. May 30, 1989). As a constitutional matter, appellants argue that the requirements of causation and redressability are not satisfied here. *See generally* L. Tribe, *American Constitutional Law* § 3-18 (2d ed. 1988). That is, they maintain that SIA's alleged injury "can[not] be traced to the challenged action of the [Comptroller]," *Simon* v. *Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 41 (1976), and that SIA "has [not] shown an injury to [it]self that is likely to be redressed by a favorable decision," *id.* at 38.

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3 That Congress' primary concern may have been to protect banks and not investment bankers is not determinative on this issue. Discussing this point, the Supreme Court said of *Camp*, "it was enough to provide standing that Congress, for its own reasons, primarily its concern for the soundness of the banking system, had forbidden banks to compete with plaintiffs by entering the investment company business." *Clarke*, 479 U.S. at 398; *see also Arnold Tours*, 400 U.S. at 46.

In focusing on these constitutional concerns, appellants seek to distinguish *Data Processing*, 397 U.S. 150, *Camp*, 401 U.S. 617, and *Clarke*, 479 U.S. 388. The Comptroller argues that in those cases it was significant that the challenged decision of the Comptroller occurred before the banks' activities and that the banks' activities could not have occurred prior to the Comptroller's approval. He maintains that in this case, on the other hand, various banks have issued mortgage pass-through certificates in the past, and that, indeed the particular issue underlying the Comptroller's June 16, 1987 decision, SPN Bank's Series 1987-B, occurred before the Comptroller made his decision. The Comptroller concludes that any injury to SIA or its members is therefore not causally linked to that decision. We reject this argument and conclude that SIA's alleged competitive injury is sufficiently linked to the Comptroller's decision to satisfy constitutional standing requirements.

In arguing that any competitive injury suffered by SIA could not have resulted from a ruling of the Comptroller subsequent to those transactions, appellants portray SIA's suit as if it is an attack merely on *past* marketing of mortgage pass-through certificates by banks. But SIA's primary concern here is not with past lost competition.[4] Rather, SIA's purpose is manifest: it fears future competition that will be permitted and encouraged by the Comptroller's interpretation of the applicable law, as reflected in the June 16 decision at issue here. *Cf. Conover*, 790

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4 It is true that SIA's complaint asked the district court, *inter alia*, to enjoin the Comptroller "from continuing in effect any other such approvals that may have been granted by the Comptroller." Nevertheless, in its brief, SIA states "[t]he [Comptroller's brief] refers to billions of dollars of mortgage-backed securities sold by banks in the past . . . , but SIA's contentions neither concern those transactions nor seek to undo them."

F.2d at 926 (recognizing implications for banking and securities industries in considering action for declaratory and injunctive relief challenging Comptroller's decision that Citibank's marketing of individual retirement accounts did not violate Glass-Steagall Act).

Appellants' argument ignores the future effects of the Comptroller's ruling approving SPN Bank's use of mortgage pass-through certificates. *Cf. id.* "The Comptroller . . . is charged by the national banking laws with the execution of all laws of the United States relating to the organization, operation, regulation and supervision of national banks and in particular with the execution of 12 U.S.C. [§] 24 which sets forth the corporate powers of national banks." 12 C.F.R. § 1.1 (1989); *see also* 12 U.S.C. § 1 (1982). Decisions issued by the Comptroller pursuant to his regulatory authority have consequences beyond the particular facts at hand. The Supreme Court implicitly recognized this in *Camp*, 401 U.S. at 624. There, the Court found that an association of investment companies had standing to bring a suit based on future competitive injury where the association challenged not only regulations issued by the Comptroller but also a decision by the Comptroller to approve the plan of First National Bank of New York to offer collective investment services. In so doing, the Court noted that the plan approved by the Comptroller was "expected, the briefs tell us, to be a model for other banks which decide to offer their customers a collective investment service." *Id.* at 622. The same would seem to be the case here. The decision by the Comptroller, issued under his statutory authority, is, in effect, a "green light" for other national banks to enter the mortgage pass-through certificate market with programs similar to that used by SPN Bank and specifically approved by the Comptroller. That analogous programs

have been approved in the past does not diminish the significance of this particular decision. SIA has provided indications that the Comptroller's ruling, until it was reversed by the district court, did in fact have the effect of encouraging this type of activity. In light of the important role the Comptroller plays in regulating the behavior of national banks, this response is not surprising. In sum, we find that this is not a case where "[t]he links in the chain of causation between the challenged Government conduct and the asserted injury are far too weak for the chain as a whole to sustain [SIA's] standing." *Allen* v. *Wright*, 468 U.S. 737, 759 (1984); *see also Simon*, 426 U.S. at 40-46.

Indeed, we think it is somewhat curious that the Comptroller bases his standing argument in part on the position that his own decision will have no causal connection to national banks' increased use of mortgage pass-through certificates in the future and therefore to the competitive injury SIA alleges it will suffer thereby. Such minimizing of the importance and impact of his own decisions is particularly anomalous in light of his arguments on the issue of laches (many banks have relied on his earlier rulings approving similar programs) and on the merits (his earlier rulings have precedential force).

We thus reject the argument that the Comptroller's decision is not sufficiently causally linked to SIA's alleged injury to support SIA's standing. We also reject appellants' related argument that SIA's injury "is [not] likely to be redressed by a favorable decision." *Simon*, 426 U.S. at 38; *see also ASARCO*, 57 U.S.L.W. at 4576. The Comptroller's decision will have the effect of permitting and encouraging national banks to market mortgage pass-through certificates. By its action for declaratory and injunctive relief, SIA seeks a judicial determination that

the Comptroller was wrong, *i.e.*, that national banks violate federal law when they market mortgage pass-through certificates as SPN Bank has done. The "likely effect," *see Von Aulock v. Smith*, 720 F.2d 176, 181 (D.C. Cir. 1983), of such a determination would be to prevent the competitive injury that SIA alleges it will suffer in the future as a result of the Comptroller's decision.

2. *Laches*

The Comptroller seeks to invoke the doctrine of laches, suggesting that "equitable considerations dictate denial of injunctive relief in this action." *New Era Publications Int'l* v. *Henry Holt & Co.*, 873 F.2d 576, 584 (2d Cir. 1989). We reject the contention that prejudice resulted from "unreasonable and inexcusable delay" by SIA in bringing this action. *See id.*

The Comptroller points to his approval of "programs closely resembling the mortgage-backed pass-through certificate programs of Security Pacific" over the course of the past ten years. SIA has been aware of these transactions, and its members have even participated in them, but SIA has not previously challenged their legality. Apparently unpersuaded by his own argument concerning traceability for purposes of standing, *see supra*, the Comptroller seeks to demonstrate prejudice by contending that national banks have relied on these earlier, unchallenged approvals of the programs and have thereby "expend[ed] financial and human resources to establish such programs."

As we have already noted, however, SIA's main concern is to prevent future competition that will be encouraged by the Comptroller's decision permitting the SPN Bank program. Its aim is not to disrupt expectations formed by

analogous pass-through certificate transactions that have occurred in the past. As SIA concedes in its brief, "[t]he [Comptroller] refers to billions of dollars of mortgage-backed securities sold by banks in the past . . . , but SIA's contentions neither concern those transactions nor seek to undo them." On that basis, we find the doctrine of laches to be inapplicable.

B. *The Standard of Review*

The issue in this case is the validity of a decision by the Comptroller that SPN Bank's sale of mortgage pass-through certificates was not violative of the Glass-Steagall Act. In assessing the Comptroller's performance of his duties, we must keep in mind the rather explicit guidance from the Supreme Court.

> [W]e cannot come lightly to the conclusion that the Comptroller has authorized activity that violates the banking laws. It is settled that courts should give great weight to any reasonable construction of a regulatory statute adopted by the agency charged with the enforcement of that statute. The Comptroller of the Currency is charged with the enforcement of the banking laws to an extent that warrants the invocation of this principle with respect to his deliberative conclusions as to the meaning of these laws.

Camp, 401 U.S. at 626-27; *see Clarke*, 479 U.S. at 403-04; *Conover*, 790 F.2d at 932 (noting that the Supreme Court's "declination to defer to the Comptroller" in *Camp* was "occasioned . . . by the Comptroller's complete silence as to the meaning of the governing statute"); *cf. Securities Indus. Ass'n* v. *Board of Governors*, 468 U.S. 207, 217 & n.16 (1984) (*Schwab*); *Board of Governors* v. *Investment Co. Inst.*, 450 U.S. 46, 68 (1981) (*ICI*).

On the other hand, this "deference is not to be a device that emasculates the significance of judicial review. Judicial deference to an agency's interpretation of a statute 'only sets "the framework for judicial analysis; it does not displace it."' " *Bankers Trust I*, 468 U.S. at 142-43 (quoting *United States* v. *Vogel Fertilizer Co.*, 455 U.S. 16, 24 (1982) (in turn quoting *United States* v. *Cartwright*, 411 U.S. 546, 550 (1973))).

With these principles of deferential review in mind, we turn first to the statute at issue here, and then to the question whether the Comptroller's construction of it was reasonable.

C. *The Glass-Steagall Act*

"Demand for divorcing banking and securities activities followed in the wake of the stock market crash of 1929." *Citicorp*, 839 F.2d at 49. Desiring to protect bank depositors after widespread bank closings, Congress enacted the Glass-Steagall Act. *See ICI*, 450 U.S. at 61. "The Act responded to the opinion, widely expressed at the time, that much of the financial difficulty experienced by banks could be traced to their involvement in investment-banking activities both directly and through security affiliates." *Bankers Trust I*, 468 U.S. at 144. As the Supreme Court has explained, Congress endeavored to eliminate not only the obvious hazards associated with banks' participation in the inherently risky securities business, but also the "subtle hazards" arising from participation in both banking and investment activity. *See id.* at 145-47; *Camp*, 401 U.S. at 630-34.

By responding to the problem by means of the Glass-Steagall Act, Congress decided upon a "broad structural approach." *See Bankers Trust I*, 468 U.S. at 147.

"Through flat prohibitions, the Act sought to 'separat[e] as completely as possible commercial from investment banking.' " *Id.* (quoting *ICI*, 450 U.S. at 70).

"Sections 16 and 21 of the Act are the principal provisions that demarcate the line separating commercial and investment banking." *Id.* at 148; *see also Citicorp*, 839 F.2d at 54 (describing §§ 16, 20, 21 and 32 as the " 'Maginot Line' of the financial world") (citations omitted). The Supreme Court has indicated that Sections 16 and 21 "seek to draw the same line." *Bankers Trust I*, 468 U.S. at 149; *see also Citicorp*, 839 F.2d at 55.

Section 16 of the Act, 12 U.S.C. § 24 (Seventh) (1982 & Supp. V 1987), draws the line from the perspective of the commercial bank. Under section 16

> [a national banking association . . . shall have power . . . t]o exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin, and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of title 62 of the Revised Statutes.

12 U.S.C. § 24 (Seventh). The section also contains the following limitation of a bank's powers:

> The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the associa-

> tion shall not underwrite any issue of securities or stock.

Id.

"Section 21 also separates investment and commercial banks, but does so from the perspective of investment banks." *Bankers Trust I*, 468 U.S. at 148. Section 21 provides, in pertinent part, that it is unlawful

> [f]or any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor.

12 U.S.C. § 378(a)(1) (1982). The section, in pertinent part, qualifies these restrictions:

> *Provided*, That the provisions of this paragraph shall not prohibit national banks . . . from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: *Provided further*, That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate.

Id.

In addition to these "line-drawing" sections of the Glass-Steagall Act, also of importance here is 12 U.S.C. § 371(a) (1982), which was amended by the Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, Title IV, § 403(a), 96 Stat. 1469, 1510, to provide that "[a]ny national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation."

D. *The Comptroller's Decision*

As it is the decision of the Comptroller that is at issue here, we review that decision in some detail.

1. *Sale of Mortgages Is Permitted*

In considering the legality of the SPN Bank transaction under federal banking laws, the Comptroller began his analysis by examining the national bank's authority to sell its mortgage loans generally. In concluding that national banks have such authority, the Comptroller relied on three bases. First, since the enactment of the National Bank Act in 1864, national banks have had the express power to "carry on the business of banking . . . by . . . negotiating promissory notes . . . and other evidences of debt." 12 U.S.C. § 24 (Seventh). Second, the Supreme Court long ago concluded that the sale of mortgages is within the incidental powers of national banks. *See First National Bank* v. *City of Hartford*, 273 U.S. 548, 560 (1927). Finally, under 12 U.S.C. § 371(a), national banks are permitted to "make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate." The Comptroller concluded that "it is clearly established

that national banks may sell their mortgage assets under the express authority of 12 U.S.C. §§ 24 (Seventh) and 371(a)."

2. *Use of the Pass-Through Certificate Mechanism To Sell Mortgages Is Either an Express or an Incidental Banking Power*

Having determined that SPN Bank had the express power to sell its mortgage loans, the Comptroller concluded "[t]he fact that the negotiation and sale may be accomplished through the creation and sale by a bank of participation certificates, an activity which [the OCC] long has approved, does not alter in any respect the substance of the transaction, nor its permissibility under the national banking laws."

The Comptroller justified permitting use of the pass-through certificate mechanism on two grounds. First, he considered use of the mechanism as simply a new way of performing the old job of selling bank assets. He cited the Ninth Circuit's admonition that "the powers of national banks must be construed so as to permit the use of new ways of conducting the very old business of banking." *M & M Leasing Corp.* v. *Seattle First Nat'l Bank*, 563 F.2d 1377, 1382 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978). He concluded that the transaction at issue here "represents nothing more than the negotiation of evidences of debt and the sale of real estate loans, which is expressly authorized under 12 U.S.C. §§ 24 (Seventh) and 371(a)."

Alternatively, the Comptroller concluded that use of the pass-through certificate mechanism to sell mortgages is an "incidental power[ ]" of SPN Bank. *See* 12 U.S.C. § 24 (Seventh). In *Arnold Tours, Inc.* v. *Camp*, 472 F.2d 427,

432 (1st Cir. 1972), the First Circuit examined several Supreme Court decisions[5] and concluded from them that

> a national bank's activity is authorized as an incidental power, "necessary to carry on the business of banking," within the meaning of 12 U.S.C. § 24, Seventh, if it is convenient or useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act. If this connection between an incidental activity and an express power does not exist, the activity is not authorized as an incidental power.

The Comptroller noted the OCC's position that the "convenient [and] useful" test of *Arnold Tours* is overly restrictive of the powers of national banks. Nevertheless, the Comptroller concluded that sale of the pass-through certificates satisfied even the *Arnold Tours* test. Emphasizing the increased marketability of mortgages packaged in the form of pools, the Comptroller said "the process of pooling bank assets and selling certificates representing interests therein can be 'convenient [and] useful' to a bank's ability to sell its assets." That is, because the pass-through certificate mechanism is a 'convenient [and] useful' means for carrying out the express power of selling mortgages, SPN Bank's sale of the certificates falls within the "incidental powers" of the national bank under 12 U.S.C. § 24 (Seventh). *See M & M Leasing*, 563 F.2d at 1382-83.

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5 *Franklin National Bank* v. *New York*, 347 U.S. 373, 385-77 (1954); *First National Bank*, 273 U.S. at 559-60; *Clement National Bank* v. *Vermont*, 231 U.S. 120, 139-40 (1913); *Miller* v. *King*, 223 U.S. 505, 510-11 (1912); *Wyman* v. *Wallace*, 201 U.S. 230, 243 (1906); *First National Bank* v. *National Exchange Bank*, 92 U.S. 122, 127 (1875); *Merchants' Bank* v. *State Bank*, 77 U.S. (10 Wall.) 604 (1871).

The Comptroller thus concluded that

> whether [SPN] Bank's use of the mortgage-backed pass-through certificate is viewed as a new way of selling bank assets or as an activity incidental to an authorized banking practice, we are satisfied that the issuance and sale of participation interests in pooled bank mortgage assets is permitted under 12 U.S.C. § 24 (Seventh).

3. *The Prohibitions and Concerns of the Glass-Steagall Act Are Not Implicated*

The Comptroller then stated that "[b]ecause the sale of bank assets through this medium is authorized under the national banking laws, the prohibitions of the Glass-Steagall Act are inapplicable to this transaction." Nevertheless, the Comptroller went on to argue that, even if the Glass-Steagall prohibitions were to be applied, they would not forbid this transaction.

First, the Comptroller found that SPN Bank's program did not involve "securities" within the meaning of the Glass-Steagall Act. The Comptroller noted that SPN Bank's registration of the offering with the Securities and Exchange Commission (SEC) did not mean that the certificates were "securities" for purposes of the Glass-Steagall Act. *See Investment Co. Inst.* v. *Clarke*, 630 F.Supp. 593, 594 n.2 (D.Conn.), *aff'd*, 789 F.2d 175 (2d Cir.) (per curiam), *cert. denied*, 479 U.S. 940 (1986); *see also Conover*, 790 F.2d at 933. The Comptroller wrote:

> Th[e OCC] has previously considered pass-through certificates representing undivided interests in pooled bank assets to be legally transparent for purposes of the Glass-Steagall analysis. In other words, because the certificateholders have essentially the same rights,

> liabilities, and risks as if they were the owners of the underlying assets, the certificates are considered to be substantially the same as those assets. . . . To the extent that the participation certificates represent "investment opportunities", the opportunity being offered is, in substance, no different than the opportunity of investment in the underlying loans which banks are clearly authorized to sell.

The means used to pool and package the sale of the mortgages was thus thought not to transform the transaction into a sale of "securities." Finally, the Comptroller reinforced his interpretation of the term "securities" by referring to his finding that the "subtle hazards" identified by the Supreme Court as motivating the Glass-Steagall Act were not implicated by this transaction. *See infra.*

The Comptroller next concluded that even if the mortgage pass-through certificates are considered "securities" for purposes of the Glass-Steagall Act, the Act was still not violated here because SPN Bank's activities did not fall within the meaning of "dealing" or "underwriting" securities, as prohibited by section 16. In concluding that SPN Bank was not "dealing" or "underwriting" here, the Comptroller said:

> An issuer that merely participates in the initial placement of its own securities with investors, and does not subsequently engage in the business of repurchasing those securities, does not thereby enter into the "business of underwriting" nor does it become involved in the "business of dealing." In this regard, we underscore the point that the activity in question is, in substance, a sale of [SPN] Bank's assets. [SPN] Bank is

> not in this transaction purchasing and selling securities of other issuers but, rather, is participating in the placement of certificates representing interests in its own assets."

(footnotes omitted).

The Comptroller followed up on his section 16 analysis by recognizing that because SPN Bank's "activities are permissible under Section 16, there is no need to conduct any inquiry under Section 21 of the Act." He nevertheless concluded that if it were applied, section 21 would not prohibit the activity at issue here. In so finding, the Comptroller again emphasized that this transaction essentially involved only SPN Bank's sale of its own assets. Further, the Comptroller relied on the specific proviso in section 21 stating that "nothing in this paragraph shall be construed as affecting in any way such right as any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate."

The Comptroller concluded by considering the purposes of the Glass-Steagall Act, finding that they were not implicated here. He first noted that the most obvious risks associated with banks participating in the securities business, *see Camp*, 401 U.S. at 630, were not present here because "[a]t no time will [SPN] Bank's resources be committed to any securities investment whatsoever, since the program involves only the sale of bank assets."

Turning to the "subtle hazards" identified by the Supreme Court, *see Bankers Trust I*, 468 U.S. at 145-47; *Camp*, 401 U.S. at 630-34, the Comptroller first noted that SPN Bank's program "does not involve the marketing of bank customers' securities." Under these circumstances, he found, "the conflicts of interest identified by

the Supreme Court . . . are simply not at issue." Because the bank has no "promotional interest" in customers' securities, it will not be tempted to make unsound loans to improve the success of the securities offerings. "Similarly, there is no possibility that the Bank might improperly advise its customers on how and when to issue securities in order to profit from the distribution process or to use the proceeds in obtaining repayment on outstanding loans."

The Comptroller next turned to the possibility that SPN Bank would offer limited credit support for the offering. He noted that the Prospectus provided that such credit support could only be, at a maximum, ten percent of the aggregate principal balance. He noted that in the absence of the sale of the mortgage loans, SPN Bank would retain 100 percent of the associated credit risk. In light of this, he found it "difficult to conceive how a decision to provide credit support for no more than 10% of the initial aggregate principal balance of a pool comprised of these same assets could be the product of 'unsound' lending practices."

The Comptroller rejected the argument that permitting use of the pass-through certificate mechanism would affect the soundness of SPN Bank's mortgage lending practices. He concluded:

> We think it extremely unlikely that a bank would engage in unsafe mortgage lending practices simply because of the possibility that the resulting mortgage loans might thereafter be placed in a pool and sold in certificate form. In this regard, at the time of origination, it will generally not be possible for the Bank to know whether a particular loan will be suitable for subsequent inclusion in a public offering. In addition, the Bank would have difficulty marketing the Certifi-

> cates if the underlying mortgages were themselves unsound investments because the federal securities laws require full disclosure of all material facts concerning the Certificates and the offering. In short, the Bank does not stand to profit by making unsound loans with the intent of remarketing them to uninformed purchasers.

Finally, the Comptroller found that SPN Bank's program would not likely result in its making unsound loans to its own depositors so as to finance sale of the certificates. "[S]ince [SPN] Bank's objective is to sell the mortgage loans, it would hardly make economic sense for it to replace these assets with unsound loans acquired in the process." The Comptroller found such a scenario equally irrational from the point of view of the depositor. Because service charges would be deducted from the "pass-through" payments, it would not make sense, the Comptroller thought, for the depositor to obtain a loan at a higher commercial rate so as to invest in the certificates.

E. *The Comptroller Correctly Determined That SPN Bank's Sale of the Certificates Was Within the "Business of Banking" and Therefore Did Not Violate the Glass-Steagall Act*

As our review of the Comptroller's decision indicates, under his interpretation of the Glass-Steagall Act, the conclusion that SPN Bank's activity was authorized by the banking laws was sufficient to resolve the dispute. That is, once the Comptroller concluded that SPN Bank's activity was encompassed by its power "to carry on the business of banking," 12 U.S.C. § 24 (Seventh), he found it unnecessary to consider the application of the Glass-Steagall prohibition on national banks' "underwrit[ing] securities,"

id. The district court appeared to accept this reading of the banking laws, *see* 703 F.Supp. at 258 ("the Comptroller's analysis could end at this point, having determined that the offering of mortgage-backed securities is within SPN Bank's power under the national banking laws"), although, as we demonstrate below, the court's reasoning and resolution were not consistent with it.

We find support for the Comptroller's interpretation of section 16 in *Bankers Trust I*, 468 U.S. at 158 n.11. In that case, the Supreme Court considered a bank's efforts to enter the business of selling third-party commercial paper. *Id*. at 139. The Court held that the commercial paper was a "security" within the meaning of the Glass-Steagall Act, thereby rejecting a decision of the Board of Governors of the Federal Reserve Board.[6] In the course of reaching this result, the Court rejected an argument made by the Board based on a provision in section 16 permitting a bank to "purchase for its own account investment securities." 12 U.S.C. § 24 (Seventh). The Board argued that if commercial paper were considered a "security" under the Glass-Steagall Act, then banks would not be permitted to purchase commercial paper for their own accounts. The Board argued that because banks had long purchased commercial paper for their own accounts with no suggestion of illegality, "the practice cannot be reconciled with § 16 unless commercial paper is not deemed a 'security.' " *Bankers Trust I*, 468 U.S. at 158 n.11.

6 Having determined that the commercial paper fell within the meaning of "securities," the Court remanded the case for a determination as to whether the bank's activity constituted "underwriting" under section 16 or "the business of issuing, underwriting, selling, or distributing" under section 21. 468 U.S. at 160 n.12. The Court of Appeals subsequently determined that the bank's activities were permitted under section 16. *Securities Indus. Ass'n* v. *Board of Governors*, 807 F.2d 1052 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987).

Of crucial significance here is the Court's reasoning in rejecting the Board's argument. Justice Blackmun, writing for the Court, said

> we find the Board's argument unpersuasive because it rests on the faulty premise that the process of acquiring commercial paper necessarily constitutes "the business of dealing" in securities. The underlying source of authority for national banks to conduct business is the first sentence of § 16, which originated as § 8 of the National Bank Act of 1864, ch. 106, 13 Stat. 101. That provision grants national banks the authority to exercise "all such incidental powers as shall be necessary to carry on the business of banking" and enumerates five constituent powers that constitute "the business of banking." One of those powers is "discounting and negotiating promissory notes." 12 U.S.C. § 24 Seventh. The Board appears to concede that the authority for national banks to acquire commercial paper is grounded in this authorization to discount promissory notes. . . . *The subsequent prohibition on engaging in "[t]he business of dealing in securities" does not affect this authority; while the Glass-Steagall Act does not define the term "business of dealing" in securities, the term clearly does not include the activity of "discounting" promissory notes because that activity is defined to be a part of the "business of banking."* In short, the fact that commercial banks properly are free to acquire commercial paper for their own account implies not that commercial paper is not a "security," but simply that the process of extending credit by "discounting" commercial paper is not part of the "business of dealing" in securities.

Id. (emphasis added). The three dissenting Justices rejected this argument. *Id.* at 167 n.8 (O'Connor, *J.*, dissenting).

We think the distinction drawn by the Court between the "business of banking" and the "business of dealing" under section 16 supports the Comptroller's approach to the issue presented in this case. The Court's reading of section 16 of the Glass-Steagall Act establishes the threshold question as whether the challenged activity of SPN Bank constitutes "the business of banking" or, instead, the "business of dealing in securities and stock." *See* 12 U.S.C. § 24 (Seventh). Activity that falls within the "business of banking" is not subject to the restrictions the latter part of section 16 places on a bank's "business of dealing in securities and stock." Thus, the issues concerning the definitions of "securities" and "underwriting" only become relevant if the activity constitutes the "business of dealing in securities and stock." If the activity constitutes the "business of banking," then the Glass-Steagall Act prohibitions SIA claims are violated here do not apply.

The Comptroller correctly concluded that SPN Bank has the express power under the national banking laws to sell its mortgage loans. In 1982, Congress amended 12 U.S.C. § 371(a) to provide that "[a]ny national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, conditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation." Legislative history indicates that the amendment was intended to "simplif[y] the real estate lending authority of national banks by deleting rigid statutory requirements. Section 403 [which amended 12 U.S.C. § 371] is intended to provide national banks with

the ability to engage in more creative and flexible financing, and to become stronger participants in the home financing market." S. Rep. No. 536, 97th Cong., 2nd Sess. 27 (1982), *reprinted in* 1982 U.S. Code Cong. & Admin. News 3054, 3081; *see also id.* at 60, 1982 U.S. Code Cong. & Admin. News at 3114.

We need not consider the extent, nature or bases of national banks' powers to sell mortgages before this amendment, as we have no difficulty concluding that the amended 12 U.S.C. § 371(a) supports the Comptroller's conclusion that SPN Bank has the express power to sell its mortgage loans.

In determining that the use of mortgage pass-through certificates to sell mortgage loans fell within SPN Bank's "incidental powers" under 12 U.S.C. § 24 (Seventh), the Comptroller turned to the test adopted in *Arnold Tours*, 472 F.2d at 432. There, the First Circuit framed the inquiry as follows: in order to be authorized under section 16's "incidental powers" provision, a national bank's activity must be "convenient [and] useful in connection with the performance of one of the bank's established activities pursuant to its express powers under the National Bank Act." *Id.*

Although he applied the test of *Arnold Tours*, the Comptroller argued that that test is unnecessarily restrictive of the powers of national banks. The Comptroller argued that several of the Supreme Court decisions relied on by the First Circuit in *Arnold Tours* in fact indicate that more flexible standards have been used. *See Franklin National Bank* v. *New York*, 347 U.S. 373, 377 (1954); *Colorado National Bank* v. *Bedford*, 310 U.S. 41, 50 (1940); *Clement National Bank* v. *Vermont*, 231 U.S. 120, 140 (1913); *Wyman* v. *Wallace*, 201 U.S. 230, 243 (1906);

First National Bank v. *National Exchange Bank*, 92 U.S. 122, 127 (1876); *Merchants' Bank* v. *State Bank*, 77 U.S. (10 Wall.) 604, 648 (1871). We have no need to address the Comptroller's position that the *Arnold Tours* test is overly restrictive, as we believe that the proper test is no more restrictive than *Arnold Tours* and we agree with the Comptroller that SPN Bank's activities here satisfied even the *Arnold Tours* test.

We have little difficulty concluding that SPN Bank's use of the pass-through certificate mechanism is "convenient [and] useful in connection with the performance of" its power to sell its mortgage loans. *See Arnold Tours*, 472 F.2d at 432. Indeed, SIA does not appear to argue otherwise. The pass-through certificate mechanism permits the bank to offer purchasers an interest in a pool of mortgage loans, rather than just single mortgage loans. The popularity of the mechanism confirms what seems apparent, that many investors who might be wary of the risk of investing in a single mortgage loan will be willing to invest in a pool of loans. With the increased marketability that pass-through certificates make possible comes increased liquidity, an important benefit as banks face the task of funding long term mortgage loans with short term deposits. We thus conclude that the Comptroller's view that SPN Bank's "incidental powers" authorized its activity in the transaction at issue here was reasonable.[7]

The Comptroller properly recognized that once he determined that SPN Bank's activity was authorized under section 16, he did not need to analyze the transaction

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7 Because we agree with the Comptroller's determination that SPN Bank's "incidental powers" authorized its activity here, we have no need to address the Comptroller's alternative finding that the activity was simply a "new way" of selling mortgages and therefore fell within the bank's express power to sell mortgages.

under section 21. "[S]ection 21 cannot be read to prohibit what section 16 permits . . . . Therefore, if we find that the [Comptroller] acted reasonably in concluding that section 16 permits [SPN Bank's] activities, that is the end of our analysis." *See Securities Indus. Ass'n* v. *Board of Governors*, 807 F.2d 1052, 1057 (D.C. Cir. 1986), *cert. denied*, 483 U.S. 1005 (1987) (*Bankers Trust II*). This is so because section 21 "was not intended to require banks to abandon an accepted banking practice that was subjected to regulation under § 16." *ICI*, 450 U.S. at 63; *see also Bankers Trust I*, 468 U.S. at 149 ("§ 16 and § 21 seek to draw the same line").

The language of section 21 supports this approach. The section imposes restrictions on those "engaged in the business of issuing, underwriting, selling, or distributing . . . stocks, bonds, debentures, notes, or other securities." 12 U.S.C. § 378(a)(1). The section then contains two provisos. The first is that the section "shall not prohibit national banks . . . from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title [section 16 of the Glass-Steagall Act]." *Id.* The second proviso states that "nothing in this paragraph shall be construed as affecting in any way such right as any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate." *Id.* The provisos, added as amendments in 1935, *see* Banking Act of 1935, Pub. L. No. 74-305, ch. 614, tit. III, § 303(a), 49 Stat. 684, 707, clarify the relationship between sections 16 and 21 and support the Comptroller's view that section 21 cannot be read to prohibit SPN Bank's activity, as it is permitted by section 16. *See Bankers Trust II*, 807 F.2d at 1057-58; *see also Citi-*

corp, 839 F.2d at 56, 60-61. That is to say, even if SPN Bank's activity here were to be considered "underwriting . . . securities," section 21 would not prohibit such activity if it were permitted under section 16, as we have found it to be.

F. *The District Court's Reasoning in Rejecting the Comptroller's Decision Was Flawed*

In analyzing the SPN Bank transaction, the district court appeared to accept the Comptroller's view that SPN Bank has the express power to sell its mortgage loans. Nevertheless, the court focused on its view that in this transaction, the "trust constitutes a separate entity from the bank," and "the pool will have a life distinct from that of the bank." 703 F.Supp. at 259. The court therefore concluded that "there is no mere sale of assets and the general statutory banking powers are limited by specific statutory prohibitions." *Id.*

The district court was obviously correct in noting that this transaction was in some sense more than a "mere sale of assets" insofar as it involved the certificate mechanism. Nevertheless, the district court failed to consider a question that is critical under Glass-Steagall Act analysis. The district court did not consider whether, its novel characteristics notwithstanding, the offering by SPN Bank fell within the bank's "incidental powers," 12 U.S.C. § 24 (Seventh), powers that are "convenient [and] useful in connection with" SPN Bank's sale of mortgage loans, *see Arnold Tours*, 472 F.2d at 432. That is, the court did not assess the Comptroller's principal conclusion, that SPN Bank's activities fell within SPN Bank's authority to conduct the "business of banking" under section 16. Instead, after noting the characteristics that distinguish this trans-

action from the traditional sale of a single mortgage loan, the district court undertook to analyze whether SPN Bank's activity constituted "underwriting . . . securities." But, as we have discussed, activities within the "business of banking" are not intended to be affected by the Glass-Steagall Act's section 16 prohibition on "underwriting . . . securities." *See supra*; *Bankers Trust I*, 468 U.S. at 158 n.11.

Because we uphold the Comptroller's decision based on his determination that SPN Bank's activities were within the "business of banking" and therefore were not prohibited by the Glass-Steagall Act, it is unnecessary to consider whether the certificates were "securities" under the Act or whether SPN Bank's activities would constitute "underwriting" under the Act. Nevertheless, we note that the district court's conclusion that SPN Bank's activity constituted "prohibited underwriting of securities" under the Glass-Steagall Act, 703 F.Supp. at 260, cannot be sustained on its reasoning. In rejecting the Comptroller's decision, the district court appeared to give determinative significance to the sale of the mortgage loans under SPN Bank's plan, by means of the pool instead of individually. 703 F.Supp. at 259. The mere fact that the certificate mechanism was used to sell otherwise salable mortgage loans transformed the transaction, in the district court's view, into the unlawful "underwriting of securities." The district court erred in attributing such significance to SPN Bank's pooling of the mortgages and sale of certificates. Interestingly, the Court of Appeals for the District of Columbia Circuit, in upholding the legality of a bank's issuance of "units of beneficial ownership" in an investment trust of individual retirement accounts (IRA), rejected an argument that because the interests were " 'undivided and redeemable interest[s] in the assets of a

common trust fund," they therefore necessarily were "securities" under the Glass-Steagall Act. In so holding, the Court said, in language relevant here,

> [i]f the term "security" were indeed interpreted [so] broadly, . . . then any ownership interest in a bank's common trust fund would constitute a security, and all commingling of trust funds by national banks would be effectively prohibited. We are at a loss to determine how a national bank could pool the assets of various trusts without creating some kind of certificates or other instruments setting forth the ownership interests of each of the participating trust assets. But such commingling . . . has historically been permitted and is clearly sanctioned by *Camp*. *See* 401 U.S. at 624-25.

Conover, 790 F.2d at 931; *see also Investment Co. Inst.* v. *Clarke*, 793 F.2d 220, 221-22 (9th Cir.), *cert. denied*, 479 U.S. 939 (1986); *Investment Co. Inst.* v. *Clarke*, 630 F.Supp. at 595-96, *aff'd*, 789 F.2d 175. While we do not find these so-called "IRA cases" to be controlling here, we do see them as undermining the district court's rationale for concluding that SPN Bank's activity constituted "underwriting of securities."

The district court also concluded that "[r]ather than [being] merely a means to facilitate the bank's needed liquidity and capital, reliance on sales of mortgage-backed certificates . . . gives rise to an interest in the success of the sales," and that such an interest conflicts with the intent behind the Glass-Steagall Act to separate commercial from investment banking. 703 F.Supp. at 260-61. Presumably, in contending that such an "interest in the success of the sales" conflicted with the intent behind the Glass-Steagall Act, the district court was referring to the

conflict of interest that may arise with respect to a bank depositor when a bank serves in the dual role of both financial adviser and investment banker. *See Camp*, 401 U.S. at 633; *see also Bankers Trust I*, 468 U.S. at 146. We are unable to ascertain precisely what "promotional interest" implicating Glass-Steagall Act concerns the district court saw as arising under the SPN Bank program at issue in this case. *Cf. Camp*, 401 U.S. at 633.

Perhaps it may be said that when SPN Bank decides that it is in its interest to sell a particular mortgage loan, it has a "promotional interest" in selling that loan. But the bank has such an interest in promoting any banking service offered pursuant to its statutory powers. This says little more than that it is in the bank's interest to sell its mortgage loans, as it is authorized to do. The mere fact that the bank has an interest in seeing that its loans are sold does not implicate the "subtle hazard" of "promotional interest" protected against by the Glass-Steagall Act. *See id.* Nor do we see how any such "promotional interest" arises simply because the bank chooses to market its loans by means of mortgage pass-through certificates instead of selling them directly. If some conflict of interest is present in the bank's simultaneously advising its depositors on financial matters and selling mortgage pass-through certificates, that conflict is no less present where the bank sells single mortgage loans directly, instead of by means of pass-through certificates. We agree with the Comptroller's explanation of why the nature of the transaction makes it unlikely that SPN Bank will make unsound loans so as to encourage purchase of the certificates. *See Bankers Trust I*, 468 U.S. at 146-47. In sum, we accept as reasonable the Comptroller's analysis demonstrating why this transaction does not implicate the "subtle hazards" legislated against by Congress in the Glass-Steagall Act.

Finally, we note that the district court's analysis seemed primarily motivated by what it considered to be "the banking laws' purpose of protecting the investing public." 703 F.Supp. at 261. The concerns of the Glass-Steagall Act, however, focus not on protecting the "investing public," but rather on ensuring the stability of banks and protecting bank depositors. *See ICI*, 450 U.S. at 61 ("It is familiar history that the Glass-Steagall Act was enacted in 1933 to protect bank depositors from any repetition of the widespread bank closings that occurred during the Great Depression."); *Camp*, 401 U.S. at 629-34. The district court felt the need to protect those who purchase the mortgage pass-through certificates by assuring that they receive full disclosure. 703 F.Supp. at 261. Instead of basing its Glass-Steagall Act analysis on the protection of investors, the court should have focused on the consequences for SPN Bank and its depositors. Protection of the purchasers of the certificates is the concern of the securities laws.

SPN Bank concedes that it "concluded long before the Comptroller's June 1987 letter" that although sale of mortgage pass-through certificates was permitted under the Glass-Steagall Act, "securities law registration and disclosure were mandated." SPN accepts that, "pursuant to § 2(4) of the Securities Act of 1933, 15 U.S.C. § 77(b)(4) [(1982)]," its activity in this transaction renders it an "issuer" under the securities laws. Accepting the requirement of registering its certificates with the SEC, SPN Bank has done so. We understand that the other banks that have sold mortgage pass-through certificates have registered their certificates with the SEC as well. Investors concerned that SPN Bank's issue might be based on bad mortgage loans it wants to unload can turn to the SEC filing to assess such risks. To the extent that SPN Bank might seek to circumvent this scrutiny by noncom-

pliance with the securities laws, investors' remedies lie in those laws. To whatever extent those looking to invest in mortgage pass-through certificates are accorded the protection of federal law, that protection must come from the securities laws and the remedies they provide, not from the Glass-Steagall Act.

Similarly, the district court's analysis as to why the certificates are "securities" under the Glass-Steagall Act unduly focused on securities laws cases. The district court criticized the Comptroller for not considering the "definition of a security." But the Glass-Steagall Act contains no such definition. *See Conover*, 790 F.2d at 933. Determining the meaning of the terms of the Glass-Steagall Act is a difficult task, one that often requires resort to the purposes behind Congress' enactment of the Glass-Steagall Act. *See, e.g., Bankers Trust I*, 468 U.S. at 149-60; *Camp*, 401 U.S. at 634-39; *Citicorp*, 839 F.2d at 56-62; *Conover*, 790 F.2d at 933-38. The Comptroller undertook such an analysis, but the district court did not, turning instead to an analysis of the meaning of "securities" in the securities law context. The district court's reasoning may demonstrate why registration of the certificates with the SEC is required under the securities laws, but that point is conceded by SPN Bank and has never been at issue in this case. Although analogies to the securities laws may be useful for purposes of ascertaining the meaning of terms under the Glass-Steagall Act, *see Bankers Trust I*, 468 U.S. at 150-52, the requirement that the certificates be registered under the securities laws does not make them "securities" under section 16 of the Glass-Steagall Act. *See Investment Co. Inst.* v. *Clarke*, 630 F.Supp. at 594 n.2, *aff'd*, 789 F.2d 175; *see also Conover*, 790 F.2d at 933-34.

CONCLUSION

The district court erred in rejecting the decision of the Comptroller that SPN Bank's issuance and sale of mortgage pass-through certificates was permitted under the Glass-Steagall Act. The Comptroller properly determined that SPN Bank's activity was within the "business of banking" under 12 U.S.C. § 24 (Seventh), and therefore was not prohibited by the Glass-Steagall Act. The judgment of the district court is vacated and this matter is remanded to the district court with instructions to dismiss the complaint.

APPENDIX B

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

87 Civ. 4504 (KTD)

SECURITIES INDUSTRIES ASSOCIATION,

Plaintiff,

—against—

ROBERT L. CLARKE AND OFFICE OF THE COMPTROLLER OF THE CURRENCY,

Defendants,

—and—

SECURITY PACIFIC NATIONAL BANK,

Intervenor-Defendant.

MEMORANDUM & ORDER

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KEVIN THOMAS DUFFY, D.J.:

This action is an appeal from a decision of Robert L. Clarke, Comptroller of the Currency ("the Comptroller") interpreting the Glass-Steagall Banking Act of 1933, Pub. L. No. 73-66, 48 Stat. 162 (codified as amended in scattered sections of 12 U.S.C.) ("the Act"). Defendant Comptroller and intervenor defendant Security Pacific National Bank ("SPN Bank") move for dismissal pursuant to Fed. R. Civ. P. 12(b)(1) or, in the alternative, for summary judgment pursuant to Fed. R. Civ. P. 56. The Comptroller also moves for dismissal pursuant to Fed. R. Civ. P. 8(c). New York Clearing House Association supports defendants' motions as *amicus curiae*. Plaintiff Securities Industry Association ("SIA") cross-moves for summary judgment pursuant to Fed. R. Civ. P. 56. For the following reasons SIA's motion for summary judgment is granted.

FACTS

In 1987 SPN Bank issued a prospectus and prospectus supplement describing a public offering of shares of private mortgage-backed pass-through certificates. The certificates, registered with the Securities Exchange Commission, represent an undivided percentage ownership in a trust that, in turn, represents a set pool of SPN Bank's conventional mortgage receivables. Once a group of mortgages are designated to a pool, the pool is fixed and the assignment to the pool trust is without recourse against SPN Bank. A separate bank serves as the pool trustee. The trust receives the principal and interest payments as they come due and will "pass-through" that income to the certificate holders. SPN Bank will service the individual mortgage loans held by the trust and distribute the monthly payments of income and principal, less a service charge earned by the bank, to the certificate holders.

Limited credit support for the certificates may be provided through one or more of the following: a SPN Bank standby letter of credit not to exceed ten percent of the initial principal balance of the pool, a limited guarantee by an entity other than SPN Bank, and third-party mortgage insurance on the lives of the borrowers obtained by SPN Bank. The remaining risks of nonpayment of the mortgage loans are to be borne by the certificate holders. SPN Bank retains none of the risks associated with the underlying mortgages except where it provides its own letter of credit. Neither the certificates nor the underlying mortgage loans are insured or guaranteed by the Federal Deposit Insurance Corporation.

An underwriting agreement for the certificates was entered into between Kidder, Peabody & Co. ("Kidder") and SPN Bank. Under this agreement, SPN Bank will sell a portion of the certificates to the public, with the remainder to be sold by underwriters. Affidavit of M. Sava B. Thomas in Support of Defendants' Motion to Dismiss or in the Alternative for Summary Judgment ("Thomas Aff."), ¶ 9. The Prospectus Supplement also provides that both Kidder and SPN Bank will be underwriters for the certificates and "may, from time to time, buy and sell" the SPN Bank mortgage-backed certificates. Thomas Aff., Exh. A at S-7.

SIA is a trade association representing securities brokerage and investment banking organizations. Kidder is a member of SIA. SIA alleges that the form of SPN Bank's offering violates the national banking laws and that, by approving the offering, the Comptroller has permitted SPN Bank to violate those laws and to compete with and injure SIA's members.

The Comptroller's Decision

In April 1987 SIA wrote to the Comptroller requesting review of the legality of SPN Bank's offering. In an opinion letter dated June 16, 1987, ("SPN Bank Letter") the Comptroller found that SPN Bank's offering does not violate the national banking laws. The Comptroller's opinion is based, in essence, on the conclusion that "the transaction in question, represents

nothing more than the . . . sale of bank assets." SPN Bank Letter at [61a].

The SPN Bank Letter notes initially that the SPN Bank offering is substantially similar in form to mortgage asset sales devices used by other banks and approved by the Comptroller since the mid-1970's. Focusing on the sale of the SPN Bank's mortgages rather than the securities form of the offering, the Comptroller determines both that the transaction underlying the SPN Bank sales device is expressly permitted by the national banking laws and that the sales device designed by SPN Bank is not prohibited by the Glass-Steagall Act.

Express permission for a national bank's sale of its mortgage assets is found in such bank's: (1) statutory authority to carry on the business of banking such as negotiating promissory notes and other evidences of debt, (2) statutory authority to make and sell mortgage loans, and (3) legal incidents of ownership in general. SPN Bank Letter at [61a-62a] (quoting, respectively, 12 U.S.C. §§ 24 (Seventh); 12 U.S.C. § 371(a); Blacks Law Dictionary 997 (rev. 5th ed. 1979)). In this context, the Comptroller emphasizes that the specific positive effects on the banking industry that are served by allowing a bank to sell its mortgage assets, especially important given the current troubled condition of the banking industry and the national economy, include both liquidity of the bank's mortgage portfolio and management of maturity mismatch problems. SPN Bank Letter at [62a].

Concluding that national banks have the authority to sell their mortgage assets, the Comptroller finds that the issuance of mortgage-backed certificates is a permissible means of accomplishing such a sale. SPN Bank Letter at [63a]. This conclusion is unchanged under the Comptroller's analysis of the certificate form as either a "new way" of performing a permitted bank activity or as an activity authorized as an incidental banking power. If the certificates fit in the former category, then the Comptroller finds that there is no need for separate authorization of the form. SPN Bank Letter at [64a]. If the certificates fit in the latter category, then the Comptroller finds that the form is authorized under even the most restrictive test enunciated by the courts. SPN Bank Letter at [64a-65a].

Although the Comptroller's analysis could end at this point, having determined that the offering of mortgage-backed securities is within SPN Bank's power under the national banking laws, the Comptroller further concludes that the certificates are not prohibited by the Glass-Steagall Act. This decision is based on the Comptroller's finding that the SPN Bank certificates are not within the definition of "securities" under the Glass-Steagall Act because, unlike mutual funds, the pooling of the underlying mortgages does not alter the fact that ownership of the certificates is substantially the same as owning those mortgages. Thus, the SPN Bank certificates are viewed by the Comptroller as assets that a bank may market, comparable to individual retirement fund assets ("IRAs") rather than to participation units in a collective fund for managed agency accounts. SPN Bank Letter at [66a-67a].

Even if the certificates are somehow determined to be securities, the Comptroller finds that the Glass-Steagall Act prohibitions, specifically §§ 16 and 21, remain inapplicable because SPN Bank is not an "underwriter." This finding is based on the determination that SPN Bank is selling its own assets rather than those of another issuer and that its power to issue its own securities encompasses the power to distribute and sell those securities to the public. SPN Bank Letter at [67a-74a].

Finally, the Comptroller finds that SPN Bank's program does not raise any of the hazards that the Glass-Steagall Act was intended to prevent because there is no danger of SPN Bank investing in speculative securities and there is no risk of SPN Bank's promotional interests interfering with its ability to act as an impartial source of credit or to render disinterested investment advice. The Comptroller supported this determination with the specific findings that: SPN Bank has no promotional interest in customer's securities and therefore no temptation to make unsound loans to influence the success of the offering; there is no possibility that SPN Bank would improperly advise a customer to profit from the distribution process or to use the proceeds to obtain repayment on outstanding loans; the possibility that the bank will retain ten percent of the risk is insufficient to cause unsound lending practices; SPN Bank's mortgage lending practice will not be affected; SPN

Bank is unlikely to make unsound loans to deposit customers to encourage purchase of the certificates; and there is no risk that SPN Bank's reputation will suffer as a result of its identification with the certificates. SPN Bank Letter at [73a-76a].

DISCUSSION

In reviewing an administrative agency's interpretation of a statute that is within the agency's regulatory jurisdiction, the agency's decision must be upheld only if it

> 'provides a reasonable construction of the statutory language and is consistent with legislative intent.' . . . [H]owever, that deference is not to be a device that emasculates the significance of judicial review. . . . A reviewing court 'must reject administrative constructions of [a] statute . . . that are inconsistent with the statutory mandate or that frustrate the policy that Congress sought to implement.'

Securities Industry Association v. Board of Governors of the Federal Reserve System, 468 U.S 137, 142-43 (1983) ("SIA I") (quoting, respectively, *Securities Industries Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 207, 217 (1983) ("SIA II") and *Federal Election Committee v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 32 (1981)). *See also Securities Industry Association v. Board of Governors of the Federal Reserve System*, 839 F.2d 47, 52 (2d Cir.), *cert. denied*, ____ U.S. ____, 108 S.Ct. 2830 (1988).

The relevant issue for review of the Comptroller's SPN Bank Letter is not simply whether or not banks can sell their assets such as their mortgage interests. Rather, the issue is whether banks can sell interests in a pool. Once a bank selects certain of its assets to be placed into a pool without recourse and offers to sell certificates of interest in that pool to the public, the assets as a group take on a separate identity. In finding that the bank can sell such interests, the Comptroller describes the trust pool as merely a "pass-through" of the underlying assets, the mortgage interests. Viewing the SPN Bank certificates this way, the

Comptroller relies on the statutory authority of banks to, in general, "carry on the business of banking" and make and sell mortgage loans. *See*, respectively, 12 U.S.C. §§ 24 (Seventh), 371(a).

With or without a formal separate legal form, however, the trust constitutes a separate entity from the bank. The interests thus sold are not merely interests in the bank itself; the pool will have a life distinct from that of the bank. Contrary to SPN Bank's argument, the trust is not merely the technical issuer of the interests in the pool, it is the primary issuer. In accepting this argument the Comptroller has ignored the fact that the pool trust has a separate bank as trustee and there is, therefore, no true pass-through of assets. The certificate holders are not buying mortgages, they cannot foreclose on an individual mortgage, and they must look to the separate bank trustee to protect their interest in the individual mortgage. The SPN Bank has the sole choice of which mortgages it wants to shift to the trust. In this situation, there is no mere sale of assets and the general statutory banking powers are limited by specific statutory prohibitions.

A bank's sale of interests in a separate entity is an underwriting of securities prohibited by the Act. The Act's prohibitions against underwriting are contained primarily in 12 U.S.C. §§ 24 (Seventh), 371(a) (respectively, "§ 16," "§ 21"). These sections contain "the principal provisions that demarcate the line separating commercial and investment banking." *SIA I*, 468 U.S. at 148. On the one hand, § 16 limits a national bank's involvement in dealing in stock and securities and prohibits the underwriting of securities. On the other, § 21 prohibits, from the perspective of investment banks, any person engaged in issuing or underwriting securities from receiving deposits. The underwriting prohibitions in each section are considered coextensive. *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 847 F.2d 890, 891 (D.C. Cir. 1988).

Although neither section defines the terms "securities," "stocks," or "underwriting" the terms should be given their ordinary meaning. *SIA I*, 468 U.S. at 149. Based on a comparison with collective investment trusts, the SPN Bank and the

Comptroller contend that the instruments at issue here are certificates that represent, in substance, an investment opportunity in the bank's assets rather than in securities. *See* SPN Bank Letter at [65a-68a]. However, when the certificates are examined in terms of the definition of a security, an analysis of the law that the Comptroller did not undertake, the facts indicate otherwise.

The Supreme Court has found that certificates representing shares of interest in a housing cooperative are not stock, because

> [d]espite their name, they lack . . . the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits." Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of shares owned; and they cannot appreciate in value. In short, the inducement to purchase . . . was not to invest for profit.

United Housing Foundation, Inc. v. Forman, 421 U.S. 837, 851 (1974) ("UHF") (quoting *Tcherepnin v. Knight*, 389 U.S. 332, 339 (1967)). Quite the opposite situation is present here. Although the SPN Bank certificates do not appear to provide any voting rights, they do represent the right to receive apportioned interest profits, are negotiable, can be pledged or hypothecated, and can appreciate in value as the interest rate fluctuates.

Likewise, the SPN Bank certificates fit within the Supreme Court's decisions defining a security.

> The essential attributes that run through [these decisions is that t]he touchstone is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others. By profits, the Court has meant either capital appreciation resulting from the development of the initial investment, . . . or a participation in earnings resulting from the use of investors' funds.

UHF, 421 U.S at 832 (citations omitted). Because the potential investors in the SPN Bank certificates will be " 'attracted solely by the prospects of the return' on [their] investment," the securities laws do apply. *Id.* at 852 (quoting *Securities Exchange Commission v. W.J. Howey Co.*, 328 U.S. 293, 300, *reh'g denied*, 329 U.S. 819 (1946)).

Under the securities laws, an "underwriter" is "one who unquestionably may participate in the primary or new issue market." *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052, 1059 (D.C. Cir. 1986), *cert. denied*, ____ U.S. ____, 107 S.Ct. 3228 (1987). "The critical attributes of underwriters, . . . are that they either purchase securities from the issuer or act as the agent of the issuer." *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 821 F.2d 810, 814 (D.C. Cir. 1987), *cert. denied*, 108 S.Ct. 697 (1988) (citing *SIA II*, 468 U.S. at 217-18 n.17). In the Prospectus Supplement, SPN Bank is both named as an underwriter and described as an entity that will fulfill the role of an underwriter of the certificates. *See* Thomas Aff., Exh. A at S-7. Therefore, contrary to the premise underlying the Comptroller's conclusions, the SPN Bank program is not merely a sale of bank assets.[1] Rather, it is a prohibited underwriting of securities within the meaning of the securities laws.

The Comptroller's policy analysis, which takes into account a bank's need to raise available capital and the troubled economy, is irrelevant under the Glass-Steagall Act. Indeed, the elements relevant to the Comptroller's analysis indicate that commercial banks should not be in the business of selling assets to the public in this way. Rather than merely a means to facili-

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1 The Comptroller's opinion states:

"An issuer that merely participates in the initial placement of its own securities with investors and does not subsequently engage in the business of repurchasing those securities, does not thereby enter into the 'business of underwriting' . . . In this regard, we underscore the point that the activity in question is, in substance a sale of the Bank's assets."

The Prospectus Supplement indicates that this opinion misstates both the facts of the activity at issue and the legal significance of the activity.

tate the bank's needed liquidity and capital, reliance on sales of mortgage-backed certificates, as described by the Comptroller, also gives rise to an interest in the success of the sales. Such an interest conflicts with Congress' intent to separate the role of a commercial bank from the role of an advocate with an interest in supporting the sale of a particular security. *See SIA*, 468 U.S. at 145-47. As the Supreme Court has indicated: "when a bank puts itself in competition with [securities dealers], the bank must make an accommodation to the kind of ground rules that Congress firmly concluded could not be prudently mixed with the business of commercial banking." *Investment Co. Inst. v. Camp*, 401 U.S. 617, 637 (1970).

Moreover, although the Comptroller recognizes legitimate concerns of the banking industry, he does not sufficiently consider the banking laws' purpose of protecting the investing public. If I were to agree that the trust certificates purchased by the public were not securities, then the public would not receive the full disclosure that is one of the protections of the securities laws. A bank could relegate to the trust those mortgages which it saw as most likely to be problems and full disclosure would not have to be made. Having once purchased the certificate, the innocent investor would be bereft of any of the protections of the securities laws, a situation repugnant to the present state of the law.

In sum, the Comptroller's statutory analysis is incomplete and inconsistent with the legislative intent and therefore must be rejected. The Comptroller's "functional analysis" does not take sufficient account of the role the bank may play in marketing the mortgage pool certificates and apparently ignores the benefits that the bank hopes to gain from the certificates. If Congress intended banks to be in the securities industry, the Glass-Steagall Act would have been revoked.[2] Congress has not done so, choosing instead to create exceptions where it believed them appropriate. *See*, *e.g.*, Housing and Urban Development

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2 As SIA has pointed out, Congress recently rejected an amendment to the Glass-Steagall Act that would have permitted banks to underwrite mortgage-related securities. SIA Mem. at 46 (citing S. Rep. No. 293, 98th Cong., 2d Sess. 9, *reprinted in* 1984 U.S. Code Cong. and Ad. News 2809, 2817).

Act of 1968, Pub. L. No. 90-448, § 804, 82 Stat. 476. The present financial plight of the banking industry is more appropriately addressed by the Comptroller and the other bank regulatory agencies in their review of bank performance in the banking industry rather than by ignoring the restrictions placed on banks entry into the securities industry.

Accordingly, SIA's motion for summary judgment is granted and the Comptroller's and SPN Bank's motions are denied.

SO ORDERED.

DATED: New York, New York
December 19, 1988

KEVIN THOMAS DUFFY, U.S.D.J.

APPENDIX C

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

87 Civ. 4504 (KTD)

SECURITIES INDUSTRY ASSOCIATION,

Plaintiff,

—against—

ROBERT L. CLARKE and OFFICE OF THE COMPTROLLER OF THE CURRENCY,

Defendants,

—and—

SECURITY PACIFIC NATIONAL BANK,

Intervenor-Defendant.

FINAL JUDGMENT

Pursuant to the Memorandum and Order issued by the Court on December 19, 1988, denying the motions of the defendants and the intervenor-defendant to dismiss and/or for summary judgment and granting the cross-motion of the plaintiff for summary judgment, it is hereby

ORDERED, ADJUDGED AND DECREED that the bank activities described in the Court's December 19, 1988 Memorandum and Order violate federal law, and the June 16, 1987 ruling of the Comptroller of the Currency approving of such activities is contrary to law, null, void and of no legal force or effect.

Dated: New York, New York
Jan. 3, 1989

/s/ KEVIN THOMAS DUFFY
U.S.D.J.

APPENDIX D

Comptroller of the Currency
Administrator of National Banks

Washington, D.C. 20219

June 16, 1987

Mr. Russell A. Freeman, Esquire
Executive Vice President and
General Counsel
Security Pacific National Bank
P.O. Box 60468
Los Angeles, California 90060

Dear Mr. Freeman:

This responds to your June 12, 1987 request on behalf of Security Pacific National Bank ("Bank"). In your letter, you ask that we provide you with a copy of our response to the letter of April 2, 1987 from the Securities Industry Association ("SIA") for a determination that the Glass-Steagall Act ("Act") prohibits the Bank from selling mortgage-backed pass-through certificates evidencing interests in pools of its conventional mortgage loans, as described in the Bank's Prospectus and Prospectus Supplement, dated January 23, 1987. You state that the Bank is requesting a copy of our response so that it may conduct its activities in accordance with our determination. Because this Office is the primary regulator of the Bank's activities, however, we have determined to respond directly to the Bank concerning the SIA's inquiry.

We have reviewed the offering materials and have concluded that the Bank's program[1] is authorized under the national banking laws and is substantially in accord with a long line of OCC precedents recognizing that the Glass-Steagall Act does not restrict the means by which national banks may sell or transfer interests in, among other assets, their mortgage and mortgage-related assets.

According to the Bank's Prospectus, a separate series of mortgage-backed pass-through certificates ("Certificates") will be issued in connection with each mortgage pool.[2] Each mortgage pool will be composed of mortgages originated by the Bank in the ordinary course of its mortgage lending activities. Upon the issuance of a certificate series, the Bank will assign the loans in the mortgage pool without recourse to a trustee for the benefit of the Certificateholders. Each Certificate will represent a fractional undivided interest in the trust property, which will consist solely of the mortgage loans in the pool for that series and certain related property, including mortgage payments awaiting distribution, property acquired by foreclosure or otherwise, and the Certificateholders' interest in any insurance policies maintained with respect to the mortgage loans.[3]

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1 We have also consulted the Bank's counsel, to obtain clarification of certain technical aspects of the Bank's program.

2 The details concerning each series of Certificates will be contained in a Prospectus Supplement to be prepared in connection with each series.

3 While the SIA's letter designates the Bank's program as involving a "distribution of collateralized mortgage obligations," that description is not technically correct. A collateralized mortgage obligation ("CMO") is a specialized mortgage-backed obligation, or bond, that is typically issued in a series of classes, with each class having an expected maturity different from the loans in the underlying mortgage pool. This serialization provides a degree of protection to investors against the risk of early maturity. *See* Financial Accounting Standards Board (FASB) Technical Bulletin 85-2: Accounting for Collateralized Mortgage Obligations, March 18, 1985. *See also* Smith and D'Annolfo, *Collateralized Mortgage Obligations: An Introduction*, 16 Real Estate Review 30-42 (Spring 1986). This Office has permitted national banks to transfer interests in their mortgage assets through the

Under a pooling and servicing agreement to be entered into with each trustee, the Bank will service the mortgages and receive a fee for this service. Distributions of principal and interest at the pass-through rate[4] will be made by the Bank, as agent for the trustee, to the Certificateholders each month. The Prospectus Supplement contains a boldface statement that the Certificates are not obligations of the Bank or its parent, Security Pacific Corporation, and that neither the Certificates nor the underlying mortgage loans are insured or guaranteed by the Federal Deposit Insurance Corporation, the Government National Mortgage Association, or any other governmental agency or entity.

Credit support for each series will be provided by a Bank-issued standby letter of credit or a limited guaranty to be issued by Security Pacific Corporation or some entity other than the Bank, and/or pool insurance to be obtained by the Bank as servicer of the loans.[5] In those instances where the Bank elects to provide its own letter of credit, the letter of credit will be issued pursuant to established credit criteria, in accordance with the Bank's normal credit extension practices. Credit coverage will

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use of CMO's in a variety of transactions. *See, e.g.*, March 24, 1987 letter of Emory W. Rushton, Deputy Comptroller for Multinational Banking, [Current Developments] Fed. Banking L. Rep. (CCH) ¶ 85,602; June 18, 1986 letter of Robert L. Clarke, Comptroller of the Currency, to Senator Alphonse M. D'Amato; May 22, 1986 letter of Richard V. Fitzgerald, Chief Counsel, [1985-87 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,532.

The Bank's program, by contrast, involves a simple pass-through certificate, which represents an undivided ownership interest in the underlying pool of mortgage loans. Pass-through certificates are designed to closely resemble the underlying mortgages with respect to the timing and amount of principal and interest payments. All of the risk of uncertain maturity due to prepayments is borne by the purchasers of the certificates, as if they were the owners of the mortgages.

4 The pass-through rate is equal to the weighted average interest rate of the mortgage loans as of the first day of the month of the creation of the trust, less the servicing compensation payable to the Bank.

5 Security Pacific Corporation is providing the limited guaranty for the certificate series described in the Prospectus Supplement dated January 23, 1987.

be provided up to the amount specified in the Prospectus Supplement, but in no event will that coverage be more than 10% of the initial aggregate principal balance of the subject mortgage pool. Provision is made for the Bank to make reimbursable voluntary monthly advances to the pool if delinquencies on the underlying mortgages cannot be covered from the funds available for distribution, but only to the extent of the amounts available under the limited guaranty or pool insurance. All risks of delinquency and loss resulting from defaults on the underlying mortgage loans that are not covered by the applicable credit support will be borne by the Certificateholders.

Under generally accepted accounting principles, regulatory accounting principles and for other bank regulatory purposes, the Bank will account for the transaction as a sale of assets. *See* FASB Statement of Financial Accounting Standards No. 77: Reporting by Transferors for Transfers of Receivables with Recourse, December 1983 (conditions for transfer to be recognized as sale under generally accepted accounting principles); Instructions, Consolidated Reports of Condition and Income for Insured Commercial Banks with Domestic and Foreign Offices, Glossary A-28 (regulatory reporting by issuing bank for privately-issued certificates of participation in pools of residential mortgages) (hereinafter "FFIEC Call Report Instructions"). In no case (other than where the Bank provides its letter of credit, as described herein)[6] will the Bank retain any risk associated with the underlying mortgages.[7]

The Certificates are to be sold in a series of public offerings registered by the Bank with the Securities and Exchange Commis-

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6 In any instance where the Bank elects to provide its own standby letter of credit, the Bank will take steps to ensure that the transaction may be reported as a total sale of assets under the FFIEC Call Report Instructions. Additionally, should the Bank provide its own letter of credit, we expect that its obligation would be exempt from the definition of "deposit" under Federal Reserve Board Regulation D, 12 C.F.R. § 204.2(a)(2)(ix), and therefore not a reservable liability.

7 In order to terminate the pool in an orderly fashion, the Bank has the option (but not the obligation) to repurchase the mortgages when the pool has been amortized to 10% of its initial aggregate principal balance.

sion. The Prospectus Supplement dated January 23, 1987 names Kidder, Peabody & Co., Inc., as underwriter and provides that this series may also be sold directly to the public by a division of the Bank. Thereafter, the Bank will not buy or sell the Certificates in the secondary market.

The Bank's program closely resembles other national bank transactions involving the sale of interests in mortgage assets, or the pledge of those assets as collateral to support a borrowing, which have received this Office's approval since the mid-1970's. Several national banks, beginning at least with Bank of America in 1977, have been permitted to sell participations in pools of their conventional mortgage loans, *i.e.*, mortgage loans that are not federally insured. *See* OCC Press Release of March 30, 1977 and letter from Robert Bloom, Acting Comptroller of the Currency, [1973-78 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 97,093 (hereinafter "Bank of America Letter"); February 14, 1978 letter from Charles B. Hall, Deputy Comptroller for Banking Operations, *id.* [1978-79 Transfer Binder] ¶ 85,100; May 18, 1978 letter from John G. Heimann, Comptroller of the Currency, *id.* ¶ 85,116; October 17, 1978 letter from H. Joe Selby, Deputy Comptroller for Operations, *id.* ¶ 85,144; April 20, 1979 letter from Paul M. Homan, Senior Deputy Comptroller for Bank Supervision, *id.* ¶ 85,167; July 31, 1979 letter from John M. Miller, Deputy Chief Counsel, *id.* ¶ 85,182; February 1, 1980 letter from Paul M. Homan, Senior Deputy Comptroller for Bank Supervision, *id.* [1981-82 Transfer Binder] ¶ 85,213; May 29, 1981 letter from Billy C. Wood, Deputy Comptroller, Multinational Banking, *id.* ¶ 85,275.

We have reviewed this Office's previous determinations concerning national banks' sale of assets through offerings of mortgage-backed pass-through certificates and we find that nearly every feature of the Bank's program has met with this Office's prior approval. *See* Bank of America Letter, *supra* (registered public offering underwritten by investment banking firm); Fed. Banking L. Rep. (CCH), *supra* ¶ 85,100 (permitting bank employees rather than underwriters to market mortgage-backed obligations); *id.* ¶ 85,116 (permitting bank's trust division rather than an independent trustee to serve as trustee for

the certificateholders); *id.* ¶ 85,213 (permitting national bank to use its standby letter of credit rather than third party mortgage insurance).

The SIA's letter states its view that the Bank's involvement in this transaction violates the Glass-Steagall Act, 12 U.S.C. §§ 24 (Seventh), 78, 377 and 378. We are providing an analysis of this transaction to demonstrate why the SIA's conclusion is incorrect.

In our view, a national bank's issuance of mortgage-backed pass-through certificates evidencing ownership interests in its conventional mortgage assets, of the sort evidenced by the transaction in question, represents nothing more than the negotiation of evidences of debt and the sale of real estate loans, which is expressly authorized under 12 U.S.C. §§ 24 (Seventh) and 371(a). More generally, this transaction involves a sale of bank assets, which is fully permitted under the national banking laws. The fact that the negotiation and sale may be accomplished through the creation and sale by a bank of participation certificates, an activity which this Office long has approved, does not alter in any respect the substance of the transaction, nor its permissibility under the national banking laws.

In language unaltered since the enactment of the National Bank Act in 1864, national banks are granted express authority to "carry on the business of banking; . . . by . . . negotiating promissory notes, . . . and other evidences of debt." 12 U.S.C. § 24 (Seventh). The term "negotiating" authorizes a bank's transfer of its notes or other evidences of debt acquired in the course of the banking business. *See Danforth v. National State Bank*, 48 F. 271 (3rd Cir. 1891); *First National Bank v. Elmer*, 278 S.W. 826 (Mo. App. 1926).

The authority for national banks to make mortgage loans and to sell such loans is provided in 12 U.S.C. 371(a), as follows:

> Any national banking association may make, arrange, purchase or sell loans or extensions of credit secured by liens on interests in real estate, subject to such terms, con-

> ditions, and limitations as may be prescribed by the Comptroller of the Currency by order, rule, or regulation.[8]

Even prior to the creation of this express authority for banks to sell their mortgage loans, however, the Supreme Court had already determined that the sale of mortgages and other evidences of debt acquired through a national bank's exercise of its express power to lend money on the security of real estate, and to discount and negotiate other evidences of debt, was authorized as part of the business of banking under 12 U.S.C. § 24 (Seventh). *First National Bank of Hartford v. Hartford*, 273 U.S. 548, 560 (1927). Thus, it is clearly established that national banks may sell their mortgage assets under the express authority of 12 U.S.C. §§ 24 (Seventh) and 371(a).

For a number of other reasons, also, a national bank's power to sell any of its lawfully acquired assets is clear. The power to sell or transfer interests in one's assets is simply an incident of ownership. Ownership is defined in Black's Law Dictionary 997 (rev. 5th ed. 1979) as the "collection of rights to use and enjoy property, including [the] right to transmit it to others." As with any other corporation, in order to operate effectively, a bank must be able to sell its assets, or interests therein, as economic conditions or safety and soundness considerations warrant. *See* Fed. Banking L. Rep. (CCH), *supra* ¶ 85,602. If banks were unable to achieve adequate liquidity through sales transactions in the relevant market for their assets, the consequences to the banking system would be serious indeed. *See* June 18, 1986 letter of Robert L. Clarke, *supra*. This Office has recognized that a bank's ability to sell interests in its long term mortgage-related portfolio serves specific banking purposes. The ability to sell mortgages which would otherwise be held for twenty or thirty years provides needed liquidity to the mortgage portfolio, resulting in the generation of additional funds for new lending and other purposes. The ability to sell mortgage assets on a regular basis also facilitates management of the maturity mismatch problems inherent in funding long term mortgages with shorter term deposits. *See* Bank of America Letter, *supra*.

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8 *See* 12 C.F.R. Part 29 (Adjustable-Rate Mortgages) and Part 30 (Real Estate Loans).

In short, prudent banking practices may require that banks sell or transfer interests in their assets from time to time. Given the current, troubled condition of the banking industry and certain sectors of the nation's economy, the need for liquidity and the ability to engage in sound asset-liability management practices is all the more important to the maintenance of a safe and sound banking system. *See* June 18, 1986 letter of Robert L. Clarke, *supra*.

Thus, there is no doubt that national banks may sell their mortgage assets or any other lawfully acquired assets. Similarly, there can be no legitimate doubt that the national banking laws permit such sales to be accomplished through the issuance and sale of mortgage-backed or other asset-backed certificates. In a recent decision addressing the scope of the "business of banking" under 12 U.S.C. § 24 (Seventh), the District Court for the District of Columbia strongly endorsed the position of this Office that it may "look beyond the label given a certain activity to determine whether or not it is permissible." *American Insurance Association v. Clarke,* No. 85-1489 (D.D.C. March 10, 1987) ("AMBAC"). The court upheld the Comptroller's determination that a national bank's issuance of standby credit in the form of municipal bond insurance was, in substance, a letter of credit, the issuance of which is a permissible banking practice under 12 U.S.C. § 24 (Seventh). Although neither letters of credit nor municipal bond insurance are specifically enumerated as permissible bank products under the national banking laws, the court recognized that extending credit is a fundamental banking practice which can take a variety of forms, regardless of the label given the activity. The court emphasized that the powers analysis should focus on the substance of the transaction in question and not proceed "from a narrow and artificially rigid view of both the business of banking and the statute that governs that business." *Id.* at 8.

The *AMBAC* analysis draws support from the case of *M & M Leasing Corp. v. Seattle First National Bank*, 563 F.2d 1377 (9th Cir. 1977), *cert. denied*, 436 U.S. 956 (1978) ("M & M Leasing") in which the Ninth Circuit determined that national banks are authorized under the incidental powers clause of 12

U.S.C. 24 (Seventh)[9] to lease personal property in circumstances where the lease is "functionally interchangeable" with a secured loan. *Id.* at 1382-83. In reaching this conclusion, the Ninth Circuit observed that whatever the scope of the powers of national banks, they "must be construed so as to permit the use of new ways of conducting the very old business of banking." *Id.* at 1382.

In view of the foregoing, it is appropriate in this instance to look beyond the Bank's use of the certificate form to the substance of the transaction, which is no more than the lawful negotiation or sale of bank assets. Since this is a permitted activity for national banks, there need not be a separate authorization for the form of the sale. *See AMBAC, supra.* The use of this form of sale by national banks, since at least 1977, is properly characterized as a "new way" of conducting an established banking practice. *See M & M Leasing, supra.*

Even if we apply the most restrictive test of "incidental to banking," enunciated in *Arnold Tours Inc. v. Camp*, 472 F.2d 427, 432 (1st Cir. 1972) ("Arnold Tours"), that for an activity to be authorized as an incidental bank power it must be "convenient or useful" to the performance of an expressly authorized banking power, the process of pooling bank assets and selling certificates representing interests therein can be "convenient or useful" to a bank's ability to sell its assets.[10] As discussed

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9 The National Bank Act provides that national banks possess "all such incidental powers as shall be necessary to carry on the business of banking." 12 U.S.C. 24 (Seventh).

10 This Office considers the *Arnold Tours* test to be overly restrictive, especially in view of the more flexible standards employed by the Supreme Court in construing the incidental powers clause. *See, e.g., Merchants' National Bank v. State Bank*, 77 U.S. 604, 648 (1871) (whether the activity has grown out of the business needs of the country); *First National Bank v. National Exchange Bank*, 92 U.S. 122, 127 (1876) (whether the activity is a reasonable and appropriate measure); *Wyman v. Wallace*, 201 U.S. 230, 243 (1906) (whether the activity is in terms prohibited by the national banking act); *Clement National Bank v. Vermont*, 231 U.S. 120, 140 (1913)

above, national banks are expressly authorized to sell their mortgage assets under 12 U.S.C. §§ 24 (Seventh) and 371(a). This Office has previously recognized that the ability to sell participation interests in pools of mortgage loans provides national banks "a new means of recycling their mortgage dollars." By packaging their mortgage assets for sale in this marketable form, national banks can more easily achieve the liquidity and asset liability management benefits discussed above. *See* Bank of America Letter, *supra*; June 18, 1986 letter of Robert L. Clarke, *supra*. Thus, whether the Bank's use of the mortgage-backed pass-through certificate is viewed as a new way of selling bank assets or as an activity incidental to an authorized banking practice, we are satisfied that the issuance and sale of participation interests in pooled bank mortgage assets is permitted under 12 U.S.C. § 24 (Seventh).

Because the sale of bank assets through this medium is authorized under the national banking laws, the prohibitions of the Glass-Steagall Act are inapplicable to this transaction. An analysis of the statute confirms that the Bank is not involved in a prohibited securities activity within the meaning of the Act.

As you know, the Glass-Steagall Act was designed in large part to remove commercial banks from the business of investment banking. *See generally* Banking Act of 1933, Pub. L. No. 73-66, S. Rep. No. 77 to Accompany S. 1631, 73d Cong., 1st Sess. (1933). In so doing, the Act addressed itself primarily to the risks to commercial bank assets and capital posed by bank participation in speculative securities investment and trading activities, as well as to the peculiar "hazards" present in the combination of commercial banking with traditional securities dealing and underwriting activities. There is no suggestion

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(whether the activity would promote the convenience of the business of banking); *Colorado National Bank v. Bedford*, 310 U.S. 41, 50 (1940) (whether the activity is a generally adopted method of banks); *Franklin National Bank v. New York*, 347 U.S. 373, 377 (1954) (whether modern competition finds the activity usual and useful). In *AMBAC*, the court has indicated even more directly that the "convenient or useful" test may be overly literal and restrictive where the transaction at issue is, in substance, itself an accepted banking practice.

either in the language or legislative history of the Act, however, that it was designed to interfere with lawful banking functions such as the Bank's program discussed herein.

First, the Glass-Steagall Act is not implicated because the Bank's program does not involve a "security" for purposes of the Act. For the following reasons, we do not believe that the pass-through certificates are properly characterized as "securities" within the meaning of the Glass-Steagall Act.[11]

In *Investment Company Institute v. Camp*, 401 U.S. 617 (1971) ("Camp"), the Supreme Court found that a bank's offering of participation units in a collective fund for managed agency accounts resulted in the illegal distribution of securities under the Glass-Steagall Act. *See id.* at 624-25. The Court determined that the bank's activity was, in substance, the creation of a mutual fund, which gave rise to all of the "subtle hazards" that Glass-Steagall was designed to prevent. *See id.* at 634-38. By contrast, in the recent IRA cases upholding the permissibility of national banks' establishing and marketing collective investment trusts for individual retirement account assets (IRAs), the Second Circuit, the Ninth Circuit and the District of Columbia Circuit all concluded that the participation units in the IRA trust funds were not "securities" for purposes of the Act. All courts affirmed the Comptroller's conclusion that these transactions were, in substance, a sale of bank fiduciary services, which did not fall within the purview of the Glass-Steagall Act. *See* IRA cases, *supra*.

This Office has previously considered pass-through certificates representing undivided interests in pooled bank assets to be

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11 Although the Bank has registered the certificate offering with the Securities and Exchange Commission, this fact, in and of itself, does not determine whether the certificates are securities for Glass-Steagall purposes. *See Investment Company Institute v. Conover*, 790 F.2d 925, 933-4 (D.C. Cir.), *cert. denied sub nom. Investment Company Institute v. Clarke*, ____ U.S. ____, 107 S. Ct. 421 (1986); *Investment Company Institute v. Clarke*, 793 F.2d 220 (9th Cir.), *cert. denied*, ____ U.S. ____, 107 S. Ct. 422 (1986); *Investment Company Institute v. Clarke*, 789 F.2d 175 (2d Cir.) (per curiam), *aff'g* 630 F. Supp. 593 (D. Conn.), *cert. denied*, ____ U.S. ____, 107 S. Ct. 422 (1986) (hereinafter collectively cited as the "IRA cases").

legally transparent for purposes of the Glass-Steagall analysis. In other words, because the certificateholders have essentially the same rights, liabilities, and risks as if they were the owners of the underlying assets, the certificates are considered to be substantially the same as those assets. *See* April 12, 1983 letter of Brian W. Smith, Chief Counsel, [1983-84 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 85,421. To the extent that the participation certificates represent "investment opportunities", the opportunity being offered is, in substance, no different than the opportunity of investment in the underlying loans which banks are clearly authorized to sell. *See* 12 U.S.C. §§ 24 (Seventh) and 371(a). We do not believe that the pooling and packaging of these assets alters the fundamental character of the transaction so as to create a security within the meaning of Glass-Steagall.[12] This conclusion is reinforced by our determination that the Bank's activities do not raise the "subtle hazards" that the Supreme Court has identified as being the focus of Congressional concern in enacting the Glass-Steagall Act. *See* discussion *infra* at pages [73a-76a].

Even if the pass-through certificates are considered securities within the meaning of the Glass-Steagall Act, however, the Act's prohibitions are still not applicable to the Bank's program. Section 16 of the Act provides, in relevant part, that the "business of dealing in securities and stock [by a national bank] shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the [bank] shall not underwrite any issue of securities or stock." This section explicitly restricts national banks' securities dealing and underwriting activities. As described in the Bank's Prospectus and Prospectus Supplement, the Bank serves as issuer of the Certificates and may also participate in their sale or distribution to the public. The first question, therefore, is whether the Bank's involvement in the distribution of these Certificates falls

12 Our position that mortgage-backed certificates are not securities under the Glass-Steagall Act draws support also from the second proviso to Section 21 of the Act, 12 U.S.C. § 378(a)(1), where Congress has indicated its clear intent not to disturb the secondary market for real estate loans made by financial institutions. *See* discussion *infra* at page [73a-74a].

within the meaning of the terms "dealing" or "underwriting" in Section 16.

The term "underwriting", as used in the investment banking business, is commonly understood to refer to the process by which newly issued securities are purchased by another firm for distribution and sale to investors. *See* L. Loss, *Fundamentals of Securities Regulation* 81-90 (1983). Similarly, the term "dealing" also generally encompasses purchase and sale activity with respect to the securities of other issuers. An issuer that merely participates in the initial placement of its own securities with investors, and does not subsequently engage in the business of repurchasing those securities, does not thereby enter into the "business of underwriting" nor does it become involved in the "business of dealing." In this regard, we underscore the point that the activity in question is, in substance, a sale of the Bank's assets.[13] The Bank is not in this transaction purchasing and selling securities of other issuers but, rather, is participating in the placement of certificates representing interests in its own

13 The Supreme Court's decision in *Securities Industry Association v. Board of Governors of the Federal Reserve System*, 468 U.S. 137 (1984) ("Becker"), does not mandate a contrary result. In *Becker*, the Court rejected the Federal Reserve Board's conclusion that commercial paper should not be treated as a "note" under Section 21 of the Glass-Steagall Act, stating that the Act does not allow for making distinctions based on the characteristics of particular notes. In addition, because the Board had issued guidelines to govern the placement of third party commercial paper by state member banks, the Court concluded that the Board had converted one of the Act's flat prohibitions into a system of administrative regulation. Also, the Court was unable to find authority in the national banking laws for the business of "dealing" in commercial paper, as opposed to bank purchases of such paper which the Court described as the business of "discounting" notes. Finally, the Court suggested that the Board's analysis had caused it to ignore the bank's role in placing the commercial paper of other issuers, a practice which the Court felt raised the very hazards that Glass-Steagall was intended to prevent. The Court observed that a bank engaged in the distribution of third party commercial paper might improperly advise its clients to issue commercial paper so as to profit from the distribution process or in order to use the proceeds of the offering to retire a debt owed the bank. The Court was also concerned that such banks might use their credit facilities to shore up clients whose commercial paper they were distributing.

assets.[14] As this Office has recently stated, Section 16 is intended to control the types and amount of national bank purchase and sale activity with respect to securities issued by others, but this section does not affect a bank's activities with respect to its own securities. *See* Fed. Banking L. Rep. (CCH), *supra* ¶ 85,602.[15] Because we conclude that the Bank's activities

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By contrast, the subject transaction raises none of these concerns. The Supreme Court specifically noted in *Becker* that the Glass-Steagall Act is not intended to affect the authority of commercial banks to conduct the business of banking. *Id.* at 158-59 n.11. Because the Bank's program in this case merely involves the sale of bank assets, which is part of the business of banking, the national banking laws, including Glass-Steagall, do not restrict the means by which this activity may be conducted. The OCC does not rely on the particular characteristics of the Bank's Certificates or establish a scheme of administrative regulation in order to assure the legality of the Bank's activity. Unlike in *Becker*, the Bank's activity cannot even arguably be characterized as "dealing" in or "underwriting" another issuer's securities but is an authorized banking practice. *See* discussion *supra* at pages [66a-68a]. Further, because, among other things, the Bank is selling interests in its own assets rather than the securities of a third party issuer, the Bank's program does not present the inherent conflicts of interest which were the focus of the Court's concern in *Becker*. *See* discussion *infra* at pages [73a-76a].

14 The fact that the Prospectus Supplement designates the Bank as "underwriter" of the Certificate series has no bearing on the Glass-Steagall analysis. Whether the Bank is underwriting within the meaning of the Glass-Steagall Act depends upon the transaction itself [*e.g.*, there must be a public offering, *see Securities Industry Association v. Board of Governors of the Federal Reserve System*, 807 F.2d 1052, 1066 (D.C. Cir. 1986) ("SIA v. Board of Governors")], and upon the Bank's role in the transaction, as discussed herein. Here, the Prospectus Supplement has merely labeled the Bank as underwriter for purposes of indicating that it may place the Certificates directly with investors, but this does not change the Bank's role in the transaction. *Cf. Becker*, 468 U.S. at 154-60 (bank's role in transaction is significant part of Glass-Steagall analysis).

15 It is also instructive to note that the Bank's conduct in this transaction does not appear to bring it within the definitions of the terms "underwriter" or "dealer" contained in the Securities Act of 1933 ("Securities Act"). The Securities Act defines "underwriter" as "any person who has purchased from an issuer with a view to, or offers to sell for an issuer in connection with, the distribution of any security . . ." 15 U.S.C. § 77b(11).

(*footnote continued*)

are specifically authorized under the national banking laws, including 12 U.S.C. § 24 (Seventh), these activities are not prohibited by Section 16 of the Glass-Steagall Act, incorporated as an amendment thereto in 1933.

If the Bank's activities are permissible under Section 16, there is no need to conduct any inquiry under Section 21 of the Act.[16] That section prohibits any organization "engaged in the business of issuing, underwriting, selling, or distributing, . . . securities" from engaging at the same time in the business of receiving deposits. Even if separate consideration of Section 21 is warranted, however, the Bank's involvement in this transaction is permitted because the Bank is not engaged in any of the prohibited businesses.[17]

In analyzing this section, it is important to recognize that it does not absolutely prohibit depository institutions from conducting the listed activities. Specifically, Section 21 provides that it does not prohibit national banks from "issuing securities" to the extent permitted under 12 U.S.C. § 24. Further, it is beyond

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Similarly, the Securities Act defines "dealer" as one who "engages . . . in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. § 77b(12). Thus, as defined in the Securities Act, both of these terms denote activity with respect to the securities of another issuer. While the broader definitions of the federal securities laws are not controlling for purposes of the Glass-Steagall Act, these statutes were enacted during the same time period, and the Supreme Court has previously sought guidance from the securities laws in understanding the ordinary meaning of terms that also appear in Glass-Steagall. *See Becker*, 468 U.S. at 150-52. *See also SIA v. Board of Governors*, 807 F.2d at 1062-64. We do not believe, however, that activities not subject to the federal securities laws could ever be subject to Glass-Steagall.

16 In a recent case addressing the interplay of these two sections, the Court of Appeals for the District of Columbia Circuit explained that Section 21 must be addressed only if Section 16 is inapplicable. *See SIA v. Board of Governors*, 807 F.2d at 1057.

17 Having determined that the Bank is not "underwriting" in violation of Section 16, no further analysis is necessary to conclude that the Bank is also not in violation of the underwriting prohibition contained in Section 21. *See Becker*, 468 U.S. at 149.

dispute that Section 21 does not affect national banks' ability to raise funds for their operations through the issuance, distribution and sale of a variety of debt and equity securities. The authority for national banks to issue these securities is evident from several different provisions of the national banking laws, and the Comptroller's regulations thereunder. *See*, *e.g.*, 12 U.S.C. § 51 (requirement of capital); 12 U.S.C. § 51c (defining "capital" as including common stock plus outstanding preferred stock); 12 U.S.C. § 51a (authorizing the issuance of preferred stock); 12 U.S.C. § 52 (prescribing form of stock certificates and indicating possibility of more than one class of stock); 12 C.F.R. § 3.100 (subordinated notes and debentures may be treated as part of capital if certain criteria are met).

In this context, the power to issue securities to raise funds for national bank operations necessarily encompasses the power to distribute and sell these securities to the investing public. In fact, national banks have for years sold their own debt and equity securities directly to investors through public offerings without there being any suggestion that this activity is barred by the Glass-Steagall Act. *See* 12 C.F.R. Part 16. Moreover, as you are aware, members of the SIA frequently assist in the marketing of mortgage-backed and other asset-backed certificates for national banks. If the "issuance" of these instruments is not legal, these SIA members could be exposed to liability under Section 11 of the Securities Act of 1933, 15 U.S.C. § 77k (civil liability for false registration statement).

For similar reasons, in considering the subject transaction, we do not believe that Section 21 is intended to affect a bank's ability to raise funds for its operations through the issuance (and distribution and sale) of certificates representing interests in its own assets. Section 21 is primarily intended to prevent investment banks from receiving deposits. Recent court decisions have emphasized, however, that the Glass-Steagall Act is not intended to bar national banks, which obviously do receive deposits, from activity that is authorized under other provisions of the Act or the national banking laws. *See*, *e.g.*, *Becker*, 468 U.S. at 158 n.11 (Glass-Steagall not intended to interfere with activities authorized as part of the "business of banking");

Board of Governors of Federal Reserve System v. Investment Company Institute, 450 U.S. 46, 63 (1981) ("Board of Governors") (Section 21 not intended to require abandonment of accepted banking practice consistent with Section 16); *SIA v. Board of Governors*, 807 F.2d at 1057 (Section 21 cannot be read to prohibit what Section 16 permits); IRA cases, *supra* (Glass-Steagall does not prohibit national banks from conducting *bona fide* fiduciary activity through operation of an IRA trust, notwithstanding recent entry of banks into this field). As we have seen, Section 16 places no limitations on the issuance of securities by national banks, and the national banking laws permit the use of the participation certificate form as a means of selling or transferring interests in bank assets. In view of this analysis, and the above discussion concerning the permissibility of various national bank securities issuances, distributions, and sales under Section 21, we think it clear that the Glass-Steagall Act does not prohibit national banks from raising funds through the issuance of certificates representing interests in their pooled assets.[18]

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18 The SIA's letter also suggests that the Bank's activity involves violations of Sections 20 and 32 of Glass-Steagall, 12 U.S.C. §§ 377 and 78. Section 20 prohibits affiliations between national banks and organizations "engaged principally in the issue, flotation, underwriting, public sale, or distribution . . . of securities." Section 32 prohibits national banks from sharing officers, directors or employees with organizations "primarily engaged" in these same activities. These sections of the Act would only be applicable if the trust created in the course of pooling the mortgage loans were viewed as an entity distinct from the Bank. In the past, since the trust is merely the vehicle used for packaging the bank's assets, this Office has considered the trust to be legally transparent and not a distinct entity for purposes of the Glass-Steagall analysis. *Cf.* Fed. Banking L. Rep. (CCH), *supra* ¶ 85,421 (pool of FHA-insured mortgages assigned to trustee considered legally transparent for purposes of Section 16).

Even if we consider the trust to be a distinct entity, however, the Supreme Court has made it abundantly clear that a one-time initial issuance of securities, as in the issuance of a closed-end investment company's shares, is not sufficient to render a company "principally engaged" in the issuance of securities within the meaning of Section 20. Otherwise, "all corporations, including banks, would at some point be engaged principally in the issuance of securities." *Board of Governors*, 450 U.S. at 60-61 n.26. For the same reasons, it seems obvious that a one-time issuance could not result in an entity's being "primarily engaged" in the issuance of securities within the meaning of Section 32. Further, as this Office has recently stated, securities activi-

Further, in the case of national banks' issuance and sale of mortgage related pass-through certificates, this Office has in the past also relied upon explicit language contained in Section 21, "that nothing in this paragraph shall be construed as affecting in any way such right as any bank . . . may otherwise possess to sell, without recourse or agreement to repurchase, obligations evidencing loans on real estate." This language is understood to reflect the intent of Congress not to disturb the secondary market for real estate loans made by financial institutions. *See* June 18, 1986 letter from Robert L. Clarke, *supra*, and letters cited therein.

Finally, a review of the Bank's program in light of the purposes of the Glass-Steagall Act, as identified by the Supreme Court in *Camp* and *Becker*, *supra*, and in other court cases, reinforces our conclusion that the Bank's activities are fully permissible under applicable law. At the outset, we note that the most obvious of the Glass-Steagall hazards, the danger of commercial bank investment in speculative stock or securities, is wholly absent from the Bank's program. *See Camp*, 401 U.S. at 630. At no time will the Bank's resources be committed to any securities investment whatsoever, since the program involves only the sale of bank assets.

The Bank's program also does not present the significant "subtle hazards" associated with prohibited bank securities activities under the Supreme Court's previous Glass-Steagall determinations. These "subtle hazards" are thought to arise when a commercial bank's promotional interest in the success of particular securities investments or its securities affiliates

ties which are authorized for national banks under Section 16 are similarly permitted for their affiliates under Section 20. *See* January 29, 1987 letter of Richard V. Fitzgerald, Chief Counsel. *See also Board of Governors*, 450 U.S. at 61 n.26 (conclusion that Federal Reserve Board regulation is permitted under §§ 16 and 21 subsumes the argument that it violates § 20); *Camp*, 401 U.S. at 626 n.12 (limitations placed on activities of national banks are at least as great as limitations placed on activities of their affiliates). Based on the foregoing, and our conclusions *supra* regarding the permissibility of the Bank's activities under Sections 16 and 21, we are satisfied that the Bank's program does not involve any violation of Section 20 or Section 32.

might interfere with the bank's ability to act as an impartial source of credit or to render disinterested investment advice. *See Camp*, 401 U.S. at 630-34; *Becker*, 468 U.S. at 145-47.

Under the Bank's program, which does not involve the marketing of bank customers' securities, most of the conflicts of interest identified by the Supreme Court in *Becker*, *supra*, are simply not at issue. The Bank does not have a promotional interest in the success of any customer's securities, thus it will not be tempted to make unsound loans to customers in order to influence the success of their securities offerings. Similarly, there is no possibility that the Bank might improperly advise its customers on how and when to issue securities in order to profit from the distribution process or to use the proceeds in obtaining repayment on outstanding loans.[19]

We also do not believe that the possibility of the Bank's providing limited credit support for future certificate series raises any Glass-Steagall hazard. In actuality, if the Bank were to issue its own letter of credit, this would only mean that the Bank would retain a small portion of the credit risk it had already incurred in the normal course of originating the underlying mortgage loans. Considering that in the absence of the Bank's sale of these assets it would retain 100% of the associated credit risk, it is difficult to conceive how a decision to provide credit support for no more than 10% of the initial aggregate principal balance of a pool comprised of these same assets could be the product of "unsound" lending practices.

Nor do we think it likely that the Bank's program will have any effect on the soundness of its mortgage lending practices. Traditionally, banks have sold their mortgage assets through loan participations, and the use of the pass-through certificate to

19 The Bank's program might affect its ability to serve as disinterested financial advisor to customers who are potential purchasers of the Certificates. This hazard, however, is not unique to the securities business. Indeed, it is present in any sale to customers of bank services or products. In fact, this very hazard was found to be present in *SIA v. Board of Governors*, *supra*, where the Court observed that " 'subtle hazards' counsel prohibition of a banking practice only when the practice gave rise to each and every one of the hazards." 807 F.2d at 1069.

accomplish such sales raises no additional safety and soundness issues. The Bank's use of the pass-through certificate to sell whole mortgage loans merely allows it to utilize the most efficient means of transferring these assets. We think it extremely unlikely that a bank would engage in unsafe mortgage lending practices simply because of the possibility that the resulting mortgage loans might thereafter be placed in a pool and sold in certificate form. In this regard, at the time of origination, it will generally not be possible for the Bank to know whether a particular loan will be suitable for subsequent inclusion in a public offering. In addition, the Bank would have difficulty marketing the Certificates if the underlying mortgages were themselves unsound investments because the federal securities laws require full disclosure of all material facts concerning the Certificates and the offering. In short, the Bank does not stand to profit by making unsound loans with the intent of remarketing them to uninformed purchasers. *See SIA v. Board of Governors*, 807 F.2d at 1068 (economic realities and impact of full disclosure under federal securities laws are relevant to hazards analysis).

We also do not believe that the Bank's involvement in this program is likely to result in its making unsound loans to deposit customers in order to finance their purchase of the pass-through certificates. Because of the servicing fee, the pass-through rate will be lower than the interest rates on the underlying mortgage loans. From the customer's point of view, it would be irrational to obtain a bank loan at the higher commercial rate so as to invest in the Bank's Certificates at the lower pass-through rate. Similarly, since the Bank's objective is to sell the mortgage loans, it would hardly make economic sense for it to replace these assets with unsound loans acquired in the process. Finally, there is no risk that the Bank's reputation might suffer as a result of its being identified with the Certificates because the Prospectus makes full disclosure of all material risks associated with the offering. Accordingly, we conclude that the Bank's program overall does not raise the conflicts of interest and other hazards that are characteristic of the securities activities prohibited to national banks under the Glass-Steagall Act.

In conclusion, we are satisfied that the Bank's program, as described in the Prospectus and Prospectus Supplement dated January 23, 1987, is squarely based on long-standing precedent that is fully supported by applicable law and subsequent court decisions interpreting these laws. In pooling its mortgage loans and selling interests therein, the Bank is merely engaging in a permitted sale of its mortgage assets. We cannot conclude that the Glass-Steagall Act is intended to preclude banks from conducting this activity. We trust that this letter has been responsive to your request.

Sincerely,

Robert L. Clarke
Comptroller of the Currency

cc: Donald J. Crawford
Senior Vice President and
Director of Government Relations
Securities Industry Association
1850 M. Street, N.W.
Washington, DC 20036

APPENDIX E

STATUTES INVOLVED

12 U.S.C. § 24. *Corporate Powers of Associations*

[A] national banking association . . . shall have power—

* * *

Seventh. To exercise by its board of directors or duly authorized officers or agents, subject to law, all such incidental power as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; by receiving deposits; by buying and selling exchange, coin and bullion; by loaning money on personal security; and by obtaining, issuing, and circulating notes according to the provisions of this chapter. The business of dealing in securities and stock by the association shall be limited to purchasing and selling such securities and stock without recourse, solely upon the order, and for the account of, customers, and in no case for its own account, and the association shall not underwrite any issue of securities or stock; *Provided*, That [a bank] may purchase for its own account investment securities under such limitations and restrictions as the Comptroller of the Currency may by regulation prescribe. In no event shall the total amount of the investment securities of any one obligor or maker, held by the association for its own account, exceed at any time 10 per centum of its capital stock actually paid in and unimpaired and 10 per centum of its unimpaired surplus fund . . . .

* * *

The limitations and restrictions herein contained as to dealing in, underwriting and purchasing for its own account, investment securities shall not apply to obliga-

tions of the United States, or general obligations of any State or political subdivision thereof . . . .

* * *

The limitations and restrictions contained in this paragraph as to an association purchasing for its own account investment securities shall not apply to securities that . . . are mortgage related securities (as that term is defined in section 3(a)(41) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(41))). . . .

. . . . .

Ninth. To issue and sell securities which are guaranteed pursuant to section 1721(g) of this title [*i.e.*, mortgage-backed instruments guaranteed by a governmental agency.]

12 U.S.C. § 378. *Dealers in securities engaging in banking business; individuals or associations engaging in banking business; examinations and reports; penalties*

(a) After the expiration of one year after June 16, 1933, it shall be unlawful—

(1) For any person, firm, corporation, association, business trust, or other similar organization, engaged in the business of issuing, underwriting, selling, or distributing, at wholesale or retail, or through syndicate participation, stocks, bonds, debentures, notes, or other securities, to engage at the same time to any extent whatever in the business of receiving deposits subject to check or to repayment upon presentation of a passbook, certificate of deposit, or other evidence of debt, or upon request of the depositor. *Provided*, That the provisions of this paragraph shall not prohibit national banks . . . from dealing in, underwriting, purchasing, and selling investment securities, or issuing securities, to the extent permitted to national banking associations by the provisions of section 24 of this title: *Provided further*, That nothing in this paragraph shall be construed as affecting in any way such right as any bank, banking association, savings bank, trust company, or

other banking institution, may otherwise possess to sell, without recourse or agreement to repurchase obligations evidencing loans on real estate.